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OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

FUTURE OF UNITED STATES-JAPAN
RELATIONS

PROCEEDINGS OF A CONGRESSIONAL RESEARCH SERVICE SEMI-
NAR ON "THE FUTURE OF U.S.-JAPAN RELATIONS: GLOBAL
PARTNERSHIP OR STRATEGIC RIVALRY?" HELD ON SEPTEMBER
27, 1991



FEBRUARY 25, 1992

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**COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

**ONE HUNDRED SECOND CONGRESS
DAN ROSTENKOWSKI, ILLINOIS, *Chairman***

ROBERT J. LEONARD, *Chief Counsel and Staff Director*

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LETTER OF SUBMITTAL

February 4, 1992

Honorable Dan Rostenkowski
Chairman, Committee
on Ways and Means
House of Representatives
Washington, D.C. 20515

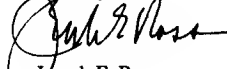
Dear Mr. Chairman:

I am pleased to submit the edited transcript of the CRS Seminar on "The Future of U.S.-Japan Relations: Global Partnership or Strategic Rivalry?" which took place on September 27, 1991 under the cosponsorship of the House Committee on Ways and Means. The seminar focused on three key issues in U.S.-Japan relations that remain highly timely: the costs and benefits of economic interdependence; the future of the global trading system in the face of intensifying competition among the three major production zones, North America, Japan and Europe; and the implications of the end of the Cold War for U.S.-Japan economic, political and security relations.

The seminar was designed and organized by Richard P. Cronin, Specialist in Asian Affairs, of the Foreign Affairs and National Defense Division, with the assistance of other analysts on the CRS Japan-U.S. Relations Major Issues Team. Mr. Cronin also prepared the transcript. The individual panels in the seminar were moderated by Dick K. Nanto, Specialist in International Economics, of the Economics Division; Raymond Ahearn, Specialist in Trade Relations and Larry A. Niksch, Specialist in Asian Affairs, of the Foreign Affairs and National Defense Division; and Mr. Cronin. Nancy Givens and Kathleen McCarthy assisted in the preparation of the manuscript.

We trust that this manuscript will contribute to the work of the Committee and the Congress as they grapple with the important trade, economic and other policy issues arising out of the complex U.S.-Japan relationship.

Sincerely,



Joseph E. Ross
Director

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U.S. HOUSE OF REPRESENTATIVES
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September 23, 1991

Mr. Joseph E. Ross
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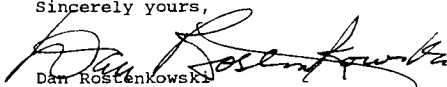
Dear Mr. Ross:

As you know, the Committee on Ways and Means has a strong interest in the issues that will be addressed in the upcoming Congressional Research Service workshop on "The Future of U.S.-Japan Relations: Global Partnership or Strategic Rivalry?" which will be held on September 27. In view of ongoing trade tensions with Japan, apparent moves towards greater protectionism in Europe, and the collapse of Soviet communism -- heretofore the main rationale for close U.S.-Japanese security cooperation -- the workshop is timely and relevant to important congressional concerns.

To help facilitate this planned activity, the Committee on Ways and Means is pleased to cosponsor the event and arrange for publishing the workshop proceedings. For further coordination, your staff should continue to contact George Weise of the Committee staff.

With warm regards, I am

Sincerely yours,


 Dan Rostenkowski
 Chairman

DR/gwp

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UNITED STATES-JAPAN RELATIONS: GLOBAL PARTNERSHIP OR STRATEGIC RIVALRY

LIST OF PARTICIPANTS

Panel 1—Costs and Benefits of United States-Japan Economic Interdependence: Implications for U.S. Competitiveness, National Well-Being and Global Role: C. FRED BERGSTEN, *Institute for International Economics*; WILLIAM BROOKS, *Department of State*; CLYDE V. PRESTOWITZ, *Economic Strategy Institute*; DICK NANTO, *Congressional Research Service*.

Panel 2—The Global Economic Power Triangle: The United States, Japan and Europe—Opening or Closing System? JEFFREY E. GARTEN, *the Blackstone Group*; ROBERT Z. LAWRENCE, *Harvard University*; BRUCE STOKES, *the National Journal*; SHINZO KOBORI, *C.Itoh & Company*; RAYMOND AHEARN, *Congressional Research Service*.

Panel 3—Outlook for United States-Japan Cooperation and Competition: Future Course of Economic, Political and Security Relations in the Post-Cold War Era: MICHAEL W. CHINWORTH, *the Analytic Sciences Corporation*; KENT M. HARRINGTON, *Central Intelligence Agency*; YUKIO OKAMOTO, *Ministry of Foreign Affairs*; LARRY A. NIKSCH, *Congressional Research Service*.

Panel 4—Plenary Session: Policy Implications and Recommendations: MICHAEL NACHT, *University of Maryland*; KEVIN KEARNS, *Economic Strategy Institute*; RICHARD P. CRONIN, *Congressional Research Service*.

WELCOME AND OPENING REMARKS OF ROBERT G. SUTTER, CHIEF, FOREIGN AFFAIRS AND NATIONAL DEFENSE DIVISION, CONGRESSIONAL RESEARCH SERVICE

Mr. SUTTER. Good morning, everyone. I'm Bob Sutter, the head of the Foreign Affairs and National Defense Division of CRS, and on behalf of the Director of CRS, Joe Ross, I want to welcome you to this important workshop and seminar on United States-Japan Relations. The topic we deal with this morning is indeed a very important one, which is no news to anyone in this audience. We are going to have a comprehensive assessment, and we have a lot of ground to cover.

We are very happy that this seminar is being cosponsored by the House Ways and Means Committee and also enjoys some special support from the Asia Foundation. But in particular I want to acknowledge the effort of one person. This seminar is the idea and the work of one individual, in particular. Although a lot of people are involved in this process in bringing it to fruition, Richard Cronin who is the coordinator of today's seminar really deserves a lot of credit for pulling it all together. Any of you that have worked on these kinds of functions know that it's quite difficult to do this sort of thing in a period of a good deal of activity on United States-Japan relations. So I'm going to, without further ado, I'm going to turn it over to Rich who will explain the ground rules and what we're going to do today. We do have a full day before us so, Rich, please.

OPENING REMARKS OF RICHARD P. CRONIN, SPECIALIST IN ASIAN
AFFAIRS, CONGRESSIONAL RESEARCH SERVICE

Mr. CRONIN. Thank you, Bob, and good morning everyone. It's very gratifying to see a good turnout for what we think is a very strong line up of speakers. I would like to especially acknowledge those who have come a long way to participate in this program, starting with Mr. Yukio Okamoto formerly from the Foreign Ministry in Japan, and Mr. Shinzo Kobori of C. Itoh & Company, both of whom have come from Tokyo to be with us today. In that respect we would like to thank the Asia Foundation for their support in making their visit possible. Dr. Robert Lawrence has also come down from Boston for the program and Jeffrey Garten will be arriving from New York imminently. So we have a number of people who have come a good ways to get here.

Before we begin Panel 1, I want to take just a few minutes to try to establish some context and theme for this workshop. Nearly 2 years ago we ran a similar program with a similarly distinguished group of panelists under the title of "U.S. Power in a Changing World." Two of our current panelists, in fact, participated in that program. If I could distill the findings of that discussion I would end up with three points that remain of relevance today. First, despite its evident relative economic decline, the panelists at the earlier seminar generally agreed that the United States remains far and away the only true superpower. Moreover, it was also seen as the only power with the ability to generate an international agenda to meet the needs of global political, military, and economic stability and to bring power to bear to carry it out. Second, U.S. problems of competitiveness were seen as real and as having complex roots. Some of these were the result of unfair trading practices, and I'll put that in quotes, if you wish, on the part of our partners like Japan, but other problems of competitiveness were seen to reflect longer term problems of lagging educational attainment, insufficient savings and investment, and excessive budget deficits. Third, it was generally agreed that economic power was becoming relatively more important than military strength as a measure of national power. This trend was seen to favor countries like Japan that had poured more resources into commercially related technology and less into the defense sector than was the case in the United States.

Recent trends and issues in United States-Japan relations have tended to validate these general propositions and establish a continuing tension between cooperation and rivalry. The collapse of communism and the end of the Cold War underscored the emergence of the United States as far and away the most powerful militarily, but also indicated the limits of this kind of power. One only has to look at the headlines today to see that the Gulf War in a sense is still not over, and we can recall of course the kind of geopolitical constraints that limited the ability of the United States to have its own way in regard to that conflict. The United States showed its raw military prowess as well as its unique capabilities for organizing the logistics of warfare. It also showed an impressive capability for political leadership in organizing a broad coalition. The United Nations organization came into its own as a vehicle for

carrying out U.S. objectives as it had not done since the Korean War. At the same time, most of the financial cost of the war was paid for by U.S. allies, most notably by Japan. The war became a litmus test of Japan's commitment to burden sharing. In the end, Japan opted to meet substantially U.S. demands to the extent of nearly \$13 billion. Japanese anguish at being relegated to the sidelines of decisionmaking during that conflict has further stimulated debate about Japan's role in the international community. While negligible in its impact on the rest of the world, the decision to send mine sweepers to the Gulf after the war and the apparent emerging consensus that Japan should play a future role in U.N. peacekeeping operations are seen by students of Japan as a watershed developments.

The scaling down and withdrawal of U.S. forces from the Pacific could, under some scenarios, create a genuinely multipolar power balance in East Asia that would pose even more basic questions for Japanese security policy. On the economic side, United States-Japan tensions continue. A combination of factors, including exchange rate adjustments, U.S. trade pressures, and the U.S. recession, have combined to reduce the trade deficit. It may well drop below \$40 billion in 1991; this is still quite high but certainly an improvement over the nearly \$57 billion deficit in 1987. The United States has also moved into surplus position with several other East Asian trading partners and European Community. Japan, for its part, is beginning to show considerable signs of underlying financial weaknesses, especially the collapses of stock prices, the related leveling off of land prices, and disarray in its corruption-tinged financial markets.

In many ways, economic interdependence has deepened. Japanese investment has substantially made up for absent domestic funds and fostered U.S. economic restructuring. Transplant factories, joint venture operations, and competitive pressures have resulted in the widespread adoption of Japanese manufacturing methods and technology. These U.S. adaptations, coupled with low input costs and economies of scale, have created a fear in some European circles of a new Japanese-American economic juggernaut.

The natural U.S. advantage of a vast domestic market and related economies of scale is being extended by the movement toward a North American free trade area. At the same time, the collapse of communism in the Soviet Union and the related end of the Cold War appear to have stiffened American resolve to press Japan for more trade and burden sharing concessions. The extent of Japan's willingness to cooperate to break the current logjam in the Uruguay round of the GATT negotiations has become a new test of its commitment to global partnership. With somewhat mixed feelings, Japan is also being looked to as a power best able to help the Soviet Union make the transition to a market economy and thereby to become integrated into the global economic system.

The panels that follow will try to look at these tensions and interactions in a systematic way. The first panel considers the cost and benefits of interdependence. The second examines larger dynamics of the three great production zones, North America, Japan, and Europe, and considers the meaning of trends towards trade blocks. The third panel seeks to integrate the bilateral and multi-

lateral economic changes with the geopolitical changes caused by the end of the Cold War. The fourth panel will consider policy implications and recommendations.

The third and fourth panels have been adjusted from that originally planned with the objective of bringing into bolder relief the basic choices for U.S. policy towards Japan. It struck me after listening to another seminar a couple of weeks ago that a kind of "right brain-left brain" divergence tends to occur when we talk about foreign political and economic issues. The "right brain" people tend to focus on security issues and power considerations and tend to have a kind of normative idea about the roles that should be played by the United States and Japan and other allies. The "left brain" people, for want of a better term, tend to focus on economic relationships and on the supremacy of economic issues as opposed to political and security issues. The more I thought about it the more it seemed to me that we needed to try to finish up with a discussion that would be headed by two "full-brained people" So I asked one full-brained person, Michael Nacht, to kindly shift from the third panel to the fourth panel to be a discussion leader for the policy analysis implications session; and I also asked Kevin Kearns to join Michael as a discussion leader for that session. Of course I'm being very facetious here and not disparaging anybody else's brain, but the basic idea was to get two speakers who had a kind of holistic or synergistic view of the relationships between political and economic issues, but who were coming from a very different perspective and emphasis. So I think that will make for a stimulating windup and hopefully will generate some good discussion about what the United States should be doing about its relationship with Japan.

That concludes my opening remarks. Without further ado, I'd like to turn the program over to Dick Nanto, a Specialist in International Economics from our Economics Division who will be moderating our first session. I thank you again, all of you, for your attendance today and we hope you enjoy the program.

**Panel 1—Costs and Benefits of United States-Japan Economic Interdependence:
Implications for U.S. Competitiveness, National Well-Being and Global Role**

C. FRED BERGSTEN, *Institute for International Economics*

WILLIAM BROOKS, *Department of State*

CLYDE V. PRESTOWITZ, *Economic Strategy Institute*

DICK NANTO, *Congressional Research Service*

**REMARKS OF DICK NANTO, SPECIALIST IN INTERNATIONAL ECONOMICS,
CONGRESSIONAL RESEARCH SERVICE**

Mr. NANTO. Thank you, Rich. Good morning, everyone, and thank you for coming this morning. I think we're in for a very instructive and interesting workshop today. In this panel, we'd like to look at the costs and benefits of United States-Japan interdependence and the implications for U.S. industrial competitiveness, national well-being, and the global role of the United States. Well there is no doubt that Japan and the United States are becoming more and more interdependent. I notice that the new Honda Accord and the Toyota Camry's are both advertising their American roots. Coca-Cola, we heard, makes more profits in Japan than it does in the United States. The Treasury Department is fretting somewhat about the lack of Japanese purchases of U.S. Treasury securities. I notice that Cray Computer announced its latest super computer in Japan. And as Rich mentioned, even in the Gulf War the new world order seems to be that the U.S. fights the battles while Japan picks up part of the bill.

In this session, we'd like to examine some of these new interdependencies and look at what it implies for United States-Japan relations and U.S. economic policy. We have three excellent panelists this morning. Our first speaker will be C. Fred Bergsten; he's Director of the Institute for International Economics, well known on Capitol Hill; he was formerly Assistant Secretary for International Affairs at Treasury; he's widely published and a recognized authority on international economic policy. Our second speaker will be William Brooks; he's a Senior Analyst for Japan at the Bureau of Intelligence and Research of the Department of State. And I consider Bill to be one of the foremost authorities on the Japanese economy in the federal government. He recently returned from a tour of duty in the American Embassy in Tokyo, and each time I would visit Tokyo I would go to Bill's office and pick up lots of good information. He participated in supporting the U.S. negotiators in all of the recent trade negotiations with Japan. Our third speaker, Clyde Prestowitz, is President of the Economic Strategy Institute. Clyde formerly was an assistant secretary in the Department of Commerce involved in trade negotiations with Japan. Clyde's book, *Trading Places: How We Allowed Japan to Take the Lead*, published in 1988, has played a major role in highlighting the need for the United States to respond to the Japanese challenge. We've

asked each speaker to take about 10 or so minutes. We'll start with Fred.

REMARKS OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR
INTERNATIONAL ECONOMICS, WASHINGTON, D.C.

Mr. BERGSTEN. Dick, thank you; it's a pleasure to be here, and I thought as the lead off speaker, what I might do would be to take stock of where we stand in the United States-Japan relationship on the economic side and ask what improvements we have seen over recent years, perhaps include developments since the last seminar here, where we saw deterioration, new problems, and continuing difficulties. Then, at the end, I will put that into the broader context of the United States-Japan relationship; and try to do all that in about 10 minutes. First on the improvements where I think there has been a lot of noteworthy change, first of all being the big decline in the global current account and balances of both countries. The United States, excluding the one-shot receipts for the Gulf War payments, has of course seen its current account deficit now drop very sharply. In the first half of this year, adjusting out those Gulf War payments, the current account deficit was running at an annual rate of \$42 billion, about 0.7 percent of GNP, down from the high of more than 3.5 percent back in 1987.

No less than the Majority Leader of the House, in a speech at my Institute 2 weeks ago, said "the trade balance problem is now over except for Japan". And that has a down side, vis-a-vis Japan, that I'll come back to, but it was a rather strong statement about the overall trade position at this point. One important implication, of course, of this decline in the U.S. current account deficit is that it makes us much less dependent on foreign financing, notably Japanese financing. So that requirement, that potential trouble spot that has been talked about a lot in the past, is at least for the moment substantially reduced.

On the Japanese side, their current account surplus came down in their fiscal year ending March to only a little over \$30 billion, about 1.1 percent of their GNP, down from something like 4.5 percent back at the peak. So again, there have been enormous changes. Now that Japanese surplus has gone up again in the first half of this year, and I'll come back to that in a moment. But over this last 4- to 5-year period, what we see very clearly is that the adjustment process works.

In my Institute, we're releasing a new study on Tuesday that Paul Krugman did for us running off a conference that Bob Lawrence and others participated in a few months back. The study surveyed the overall external positions of the big countries, United States, Japan, Germany, and asked whether the currency changes and other related moves had in fact worked as the models had suggested and as the policy makers had hoped. The answer was basically yes. Not perfectly, but on the whole yes, big changes on that big part of the picture. Now for a while, there were doubts of course that that was going to happen, and there were also questions about whether it would trace through to the bilateral United States-Japan account. Not that we should focus on that, but obviously a lot of people do and it's important. And here, too, big

progress. The bilateral current account imbalance between United States and Japan—this is U.S. figures—dropped from \$51 billion in 1988, to \$43 billion in 1989 and to \$41 billion in 1990. And it has not gone back up in the first half of 1991 despite the renewed rise in Japan's global current account position.

That is quite an accomplishment to cut the current account imbalance that much. If you think back to 1987 when the bilateral imbalance peaked, remember that U.S. imports from Japan were three times as great as U.S. exports to Japan. So just to hold even, just to keep that deficit from getting worse, our exports had to grow three times as fast as our imports. Well, in fact, they've grown about six times as fast, and therefore the current account imbalance has come down dramatically as well from over \$50 billion to about \$40 billion in 1990, and it's running at about the same level in the first half of 1991.

In fact, at that level, some would argue we're not too far from equilibrium. Japan, of course, in its global position, is always going to run a deficit with OPEC, Australia, and other countries from which it imports raw materials; it's going to run surpluses to offset that with the high income industrial countries to which it exports its manufactured goods. One could haggle whether longrun equilibrium current account position between United States and Japan is \$20 billion or \$30 billion or \$40 billion, but we're probably not very far from that at the level that was reached over these last 18 months. And as I say, we've got a study coming out next week that documents all of this, gives it in detail if you want it.

I think point one on the improvement side is this really very big fundamental change in terms of the global and bilateral current account positions of the two countries. A second element that I would regard as progress is the reduction of tensions surrounding the inward foreign direct investment issue. Again, not to say that in any of these areas the tensions have disappeared, but in trying to add up improvements versus problem areas, I'd put that on the improvement side.

Part of that reduced direct investment inflow is a reflection of what I already talked about, the declining current account deficit and therefore the need to import capital, but it is rather stunning that the total inflow, the global inflow of direct investment to the United States in the first half of this year was running at an annual rate 20 percent, one-fifth, the level of 2 years ago. Now the Japanese share is up, but its amounts are also down very, very sharply, reducing again the potential for tension arising out of that set of issues.

The second set of issues that I think point in the improvement direction is the quite extensive set of United States-Japanese negotiations over the last 5, 6, 8 years, which in fact have had pretty fruitful results. On the macroeconomic side, I already talked about the big dramatic changes in the current account imbalances; that of course was fostered, promoted by the Plaza agreement in 1985, the Louvre agreement in 1987, the continuing G-7 process to improve the global multilateral and bilateral context of these aggregate positions. The yen/dollar agreement which, process is by no means complete, pushed the opening of the Japanese financial markets.

We don't often put Third World debt in this context, but we should remember that the Brady plan for all its shortcomings has in fact taken the Third World debt crisis off the front pages and off the front burner of the policy agenda; that of course was funded by \$10 billion by Japan, among others, and added one more to the success stories I think of these negotiations. On trade, the MOSS talks, I think, have shown a pretty good market payoff; the cash register has been ringing on some of those products.

We've got another study coming out soon by Laura Tyson looking at the question of managed or mismanaged trade which puts up the MOSS results as pretty good ones, showing that process may in fact be a model for dealing with some more sectorial problems in the future. The SII outcomes are a little early yet to evaluate; nevertheless, there have been some requisite changes in Japanese law. Clear changes in fiscal policy could keep government expenditures running, keep domestic demand growing in the economy so that on that front, too, one could I think say that some of the structural issues have begun to be addressed.

Richard already mentioned the burden-sharing in the Gulf War, where the United States in fact I think has over-financed the marginal costs of the war, including contribution from Japan. That's one reason why when you take those payments into account, you actually get a big U.S. current account surplus in the first half of this year.

So the conclusion from all this, and I think it's an important one, is that Japan is changing. I make the point because there are people who still say from time to time Japan can't change or won't change or isn't changing. There has been enormous change. The Japanese have recently produced a kind of 5-year report card on the Miyakawa report recommendations. Miyazaka and Okito have prepared that; they are going to do a more elaborate version. And it fully recognizes that lots more is to be done. Nevertheless, the changes in all these areas have taken place, in some cases rather significantly so.

Perhaps to someone looking at the macro picture the key point is that over these last 5 years, Japan has been pursuing domestic-led growth. Over these last 5 years since the Miyakawa report, the Plaza agreement, domestic demand growth in Japan has averaged 5.5 percent a year; the external sector has been a drag on the economy to the tune of an average of six-tenths of 1 percent a year, that's a decline of 3 percentage points over that period, reducing as I said before, the current account surplus to a much lower number. But the conclusion: Japan does change: is changing, lots of progress in this direction. Now that's the good news.

There's obviously some bad news as well, and one has to tick off a number of elements to that account in both the macro and the micro senses. To take the flip side of Congressman Gephardt's comment of 2 weeks ago, Japan is now two-thirds of the U.S. global deficit. Even if you believe with Gephardt that the overall trade balance problem is over, the Japan problem in a sense then sticks out even more like a sore thumb than it did in the past. Representing actually three quarters of our current account deficit in the first half of this year, representing something like two thirds of our merchandise trade deficit. And so there clearly remains an agenda

item of that account. Second, we know that the Japanese surplus over this last 6 month period in particular, vis-a-vis Europe, has been rising very sharply leading to lots of European reaction. In fact the pointed statement by Jacques Delors earlier this week, "Europe is in economic and trade war with Japan." Delors is fond of saying that they are going to learn from the American experience and not go through some of that same stuff that we went through. I'm not sure he learns the right lessons, but he certainly has that in mind and others in Paris do as well, as we know.

That of course heats up one important leg of the global tri-polar relationship in terms of trade frictions as Europe reacts, e.g. with its new limitations on auto imports; that will of course generate deflection pressures into our market. This could heat up difficulties here again, and it also leads the Europeans from time to time, as Delors did when he was here 3 months ago meeting with the President, essentially to suggest that the United States and Europe gang up on Japan to try to deal with some of the remaining trade problems. So those issues clearly remain a source of friction even at the macro level.

At the micro level, we all know the litany of sectorial problems that continue, I won't tick them off, in a number of high-tech products. The auto sector, again, now begins to stick out like a sore thumb. As I mentioned, Japan is something like two-thirds of our trade deficit. Three quarters of the bilateral trade in turn is autos and auto parts. So if you want to zero in from the aggregate numbers and say what is the problem in terms of at least the trade side, it's Japan and autos. And that comprises the great bulk of U.S. global trade imbalance that remains after all this progress that I have noted.

Many of the current problems, including the auto sector of course, focus on the keiretsu issue and continue to focus on the relatively high import propensity of the Japanese companies here. Some of you probably looked at the study on foreign investment in the United States that we published 18 months ago by Paul Krugman and Monty Graham; we will be releasing an updated, revised version of that one next week as well. That brings the data up to 1989 looking at the record, the economic performance of the Japanese subsidiaries here, vis-a-vis U.S. firms, vis-a-vis other foreign firms. And it shows on the good side that the Japanese firms continue to spend as much or more on R&D per worker, value added per worker, etc. as do other firms. It also continues to show that the Japanese firms import something like six times as much per worker as U.S. firms and three times as much as other foreign-based firms. The question of where the inputs are coming from—whether the United States gets the full fruits of the foreign investment as one would hope and expect from the record of direct investment from the rest of the world—remains at a minimum an open question. And as the data now go on at least a few more years, one begins to think more and more that that may be a problem that would require some direct attention.

The one other problem on the aggregate side that I would mention is this renewed increase in the Japanese current account surplus on a global basis, particularly toward Europe and Asia. I think in part it is explained by the rapid growth of capital goods demand

during last year and early this year in both East Asia and Germany; a big increase in the Japanese surplus was with Germany alone in bilateral terms. Nevertheless, the ability of the Japanese economy to move so fast to pick up market share again raises the question of whether the yen has again become undervalued.

I would suspect, based partly on MITI's (Ministry of International Trade and Industry) own survey of what the equilibrium rates are from the standpoint of Japanese business, that the yen is again undervalued, at least on the order of 10 to 15 percent. The latest MITI survey shows that the average Japanese firm says it can still compete very nicely in the world of 129 yen to the dollar; the big firms say they can do it at 120 to the dollar. The yen is still somewhere in the mid-130s, i.e. about 10 percent under valued in terms of its trade competitive relationship and that issue, I think, needs to be back on the agenda.

Another big piece of bad news that I think needs to be confronted squarely and has big implications to the United States-Japan relationship is the stalemate in the Uruguay round. If the Uruguay round were to fail, then I think it's quite predictable that at least in this country, but elsewhere as well, there would be a rash of unilateral and bilateral trade action undertaken moving to some extent in a protectionist direction.

We note the rice issue and lots of other United States-Japan trade issues have been deliberately assigned to Uruguay round for solution. If the round were to fail, there would be both a broad effect in that the whole multilateral trading system would be discredited and unraveling would occur, and also in direct bilateral terms the number of issues that have been relegated to that negotiation would immediately leak back for bilateral talks and or unilateral reaction by the United States itself. That makes it inexplicable to me that Japan has therefore let itself be cast as one of the villains in producing the stalemate in the Uruguay round as it did with its position on agriculture in Brussels last December.

We all know that at the end of the day, Japan is going to have to liberalize its rice market for internal as well as external reasons. The continued inability to be able to do that by an advanced state as part of an effort to help the rounds succeed, as part of an effort to keep Japan from being labeled along with the Europeans as the cause of a failure of the round seems to me just an enormous mistake from Japan's standpoint, and a significant addition to possible new frictions between the countries. Running off that issue is the related trade question of the relative role of the next 5, 10, or more years, of regional trading arrangements versus blocs. And here I would say only that if the Uruguay round were to fail, I think there would be an enormous impetus given not only to unilateral and bilateral trade protectionist measures as already measured, but also to regional arrangements as countries, notably this one, began to look for alternatives to a global system that had demonstrably not done its job. I don't think the United States would in fact look to its own region as a satisfactory response to trade blocs elsewhere, simply because the Western Hemisphere would hardly be an adequate trading area for the United States to relegate itself to in a world where the viability of the global system was undergoing some doubts.

We love our friends in the Western Hemisphere, but they are not only all developing countries, they are all debtor countries. Since we are the largest debtor, that's not exactly what we need. This would be the way to create the debtors cartel. Forget the Cartagena agreement, do the enterprise for the America's initiative on the financial side and you'd have the debtors cartel. But I don't think the United States would be satisfied with that.

Likewise, I don't think in a world where the global system of trade was at risk too many Asian countries would want to look to an Asian bloc led or dominated by Japan. And therefore, my suspicion is that the dynamic, from both sides of the Pacific, would be towards Pacific basin arrangements perhaps growing off the embryonic institutional framework of APEC. And that particularly if the Europeans were the trigger point for breaking up the global system with the failure of the Uruguay round, that the rest would begin to coalesce against them and there would be a Pacific basin dynamic.

Now that in turn of course would run into the major roadblock of the United States-Japan problem. And the question would be whether a galvanization from that front, which I certainly don't advocate or hope, but could see happening if the Uruguay round failed, whether a galvanization from that front would enable the United States and Japan to come effectively to grips with their remaining problems and join hands in a kind of G-2 arrangement to lead a rest of world economic liberalization, or whether that conflict would be so great that you get into very, very messy competition for Korea, Taiwan, ASEAN, etc., as the two countries, the United States and Japan, competed for influence, economic payoff and the like from that sphere. That could become the biggest United States-Japan issue anytime over the next year or so if the Uruguay round were to fail. A decidedly undesirable situation but one not to be ruled out.

Well, where does all of this leave us? Some progress, some continued problems. What is the net. It seems to me we are in an uneasy lull right now in the United States-Japan relationship. Not that it's dull, but relative to previous crisis periods it's somewhat quiescent state. There has been lots of progress, but as I say, still lots of problems. And with the end of the Cold War, the basic security framework has been changed. The Cold War did provide this security blanket over relations, both between the United States and Europe, the United States and Japan, which tended to submerge conflict on all other issues including economic issues. And we know that the United States frequently pulled its punches on economic issues in order to avoid jeopardizing the overall political imperative which was the alliance against the Soviet threat. Now with the end of the Cold War that security blanket has been pulled aside meaning that other issues, including economic issues, are much more apt to bubble to the surface, generate true conflict.

I frankly do not think that the Uruguay round would have gone into this stalemate as recently as 2- or 3-years ago because I don't think the United States would have demanded as much from its allies, and I don't think the allies would have resisted nearly as strongly had the United States done so. Now, with the other countries not needing U.S. protection as much, with the United States

feeling much less need to protect them and maintain the security alliances, the economic issues come to the fore. When you couple that with the onset of truly tri-polar economic power around the world—in fact we do now have three economic superpowers including Japan and the united Europe along with the United States—you have a recipe for much greater potential conflict than you have ever had before.

In addition to continuing to slog away on the bilateral issues, which certainly will have to be done, all the ones I ticked off and some more that all of you can name; I think we are also going to need some new global initiatives led, hopefully, by a G-3 of the United States, newly uniting Europe, and Japan. But if Europe is going to be too inward looking for a while and can't play, then the United States and Japan may have to try to do it on a G-2 basis. Global initiatives will be required to build on the revival of reference ranges within the G-7, to strengthen the monetary system and avoid renewed imbalances like this new yen under-valuation. At a minimum on the trade side. This means bringing the Uruguay round to a successful conclusion but probably moving beyond it to do much more: maybe creating a GATT for investment to deal with the wide range of investment issues, including those stemming out of the keiretsu; perhaps agreements at the micro level like on global competition policy to deal with the keiretsu, the European's extraterritorial use of their new antitrust weapons and the like.

I think we need to raise our sights toward a whole agenda of global initiatives that begin to look both towards global economic purposes but also as the most constructive way to take the United States-Japan relationship to the next stage that would be appropriate for the world's two largest economies. Now all that won't be so easy. The United States has to be pursuing what I call a policy of competitive interdependence. It has to do a great deal to beef up its own competitive capability here at home ranging across macro and micro issues. It has to at the same time be willing to share power, not just ask other countries to write checks, and that is a difficult psychological adjustment for a country which has been the dominant power in the working lifetime of all of us in this room, and all people who deal in the policy area today. Likewise, Japan has to make the enormous psychological shift from viewing itself as an insular free-rider on the world's security and economic systems to being a full partner in maintaining those systems.

If you want to view this as a continuum, you see the United States coming from the end of the previous dominant partner, the Japanese coming from the end of having been the dependent, free-riding, benefited partner, moving from those opposite ends of the spectrum somewhere towards the middle in terms of accepting and exercising joint leadership and responsibility for the whole process. At the end of the day, what we may be seeing is a new form of world competition, competitive cooperation. The cooperation I've already talked about and mentioned the need for. The competition between competing models of capitalism.

There is interesting work now coming out of Japan regarding Japan as a noncapitalist market economy meaning a market economy where the firms follow the interests of the "stakeholders" more than the shareholders as compared with American style capitalism.

And it may be not the "end of history" with the end of the Cold War and the demise of the ideological conflict, but rather the dawn of a new type of—call it conflict, call it competition, call it challenge from different styles of capitalist economic effort to see which is superior, which can win the competition, which can win more adherence around the world and which proves to be more successful. As we grope toward the answer to that question, we are going to have to between these two world's largest economies find new modes of cooperation as well to keep the world economy going, and I would say it's a system that requires the United States to pursue a policy of competitive interdependence working both on the domestic and global sides of the package simultaneously. Thank you very much.

REMARKS OF WILLIAM BROOKS, SENIOR ANALYST FOR JAPAN BUREAU
OF INTELLIGENCE AND RESEARCH, DEPARTMENT OF STATE

Mr. BROOKS. That's a very hard act to follow. I've been told by the Department to make this statement before I present any words that I am not here as a spokesman of the State Department and whatever foolish words come out of my mouth are my own fault and not the Department's. Most of what I'll be saying today is actually based on my own experience. Up until last Fall I was in the Embassy, a 3 year tour in the Economic Section, working on economic policy areas and during the last exciting year on SIL. So the experience that I have allows me I think to look at the Japanese economy—whether it's changing or not—and to make some judgments as to how that impacts on United States-Japan relations.

As the usual case with United States-Japan relations there is both good news and bad news. The good news is that there indeed has been a lot of change in Japan's economy, its structure, and its economic policies thanks to both market forces, yen-driven market forces, negotiations and policy changes. And this has benefited the United States in terms of sales in Japan and investments here. The bad news is that these changes still have not progressed far enough, the structural changes in particular, so that there are parts of the Japanese economy which still do not reflect adequately market forces. This is one reason I think why Japan appears to be slipping back into a mode of export driven growth. The increased surpluses that are occurring are with Asia and the EC. And the other bit of bad news is that the changes, yen driven changes, and others indeed seem to have made Japan's manufacturing sector even stronger than before. One of the things that I wanted to do in preparation for this talk was to take a look at the press announcements of Japanese investments, tie ups, or other kinds of agreements. I couldn't keep up with the flow. There is an incredible drive among Japanese corporations to have a major market presence in every part of the world. And a lot of that is competition for us. But many of the announcements actually show, and as many of you know, that the arrangements are quite complex. United States and Japanese companies getting together, tie ups, strategic alliances, even joint development of products. European companies like tying up with Japanese companies; it is very complex.

The ultimate conclusion that I came to in basically after about a week of looking at tons of material was that it's the tail wagging the dog. Policy is no longer driving the Japanese economy as it moves offshore; it's the millions of transactions of Japanese corporations that may be the reality we have to deal with. We may find that we are competing very strongly in Third World markets more than we are competing in our own markets and that we may be cooperating in many of those markets with the same companies that are competing in other markets. It becomes more and more complex. Now our approach to Japan I think has been reflecting parts of the complexities of interdependence that have been occurring. As Mr. Bergsten has pointed out, it shows up in the figures in terms of the current account balance, in terms of the investments that are coming into our economy, and in terms of the sales that are occurring, the vast exports that we have with Japan.

So our approach has been to move away, I think, from the sector or the specific product-based negotiations and into the structural approach. The problems as we found out in SII are no longer at the border but within the Japanese system, within the Japanese corporate culture, within the Japanese regulatory environment, within the way that Japan does business inside of Japan and outside of it.

We still have our traditional approaches of Japan, but more and more I think the SII format will take up more and more of our existing agenda as we continue a follow-on looking at structural problems and perhaps adding new ones that are related to the original process. The reason why I say this, as I mentioned earlier, is my own feeling that parts of the Japanese economy do not operate along market force lines. I would say about half of it does not, and this is not my own opinion, these are statistics that exist in Japan.

The Fair Trade Commission did a study in the late 80s of regulatory control of the Japanese economy and came up with the conclusion that about 40 to 50 percent of the economy is heavily regulated, under obsolete laws and regulations which perhaps sometimes don't make any sense but allow bureaucrats to control supply and demand relations in Japan. Interestingly enough, we aren't the only ones who are targeting these regulations, which have been calculated, counted by some think tanks as numbering about 11,000. The Japanese too have their own agenda for administrative reform and deregulation which they hope over the 10-year period will reduce the interference or the intervention of the government into the economy. This can only mean that it will be a lot easier for newcomers, including foreign businessmen, to do business in Japan. And indeed there is on the books, or will be on the books soon, an administrative procedures law in Japan that will make the notorious use of administrative guidance by bureaucrats open and transparent and probably in writing. At any rate, this agenda for deregulation is extremely important. We picked it up in SII with our focus on the distribution sector but it also extends to transportation, financial energy, and a host of other areas, particularly agriculture as you know. And we have tried, in our SII approach, to get the Japanese government to recognize that the anti-monopoly law had to be beefed up. They did; They acknowledged their fair trade commission had to be strengthened and it was; and that guidelines had to be issued to the Japanese business sector to

make them play fair and to practice their business as if it were in an international environment. My own thesis on this is that the Japanese business sector is probably the only force for positive change in the Japanese environment today. SII showed that consumers, yes, were very much interested in change but had no clout and that the only real allies that we had to move the process forward, except in a few areas like keiretsu or areas of business practice, were within the Japanese big business section. Of course, big business can be our competitor making it difficult for us to get into the Japanese market: but they also at times can be our allies because the same kinds of problems that a newcomer, a foreign company, encounters in Japan, a Japanese company that imports, will encounter also. The SII revealed, too, I think for me that change was going on in the Japanese society; that Japan indeed was becoming a pluralistic society. And popular support for change has had an impact through SII and other means in public policy. Let me give you an example. The deregulation of the large store law basically was supported by big business, but it also gradually showed up in public opinion polls so that by the end of the SII process a large number of Japanese consumers were convinced that this was good for their interests.

Another way it shows up is in the trade statistics. With the depreciation of the yen, most of the changes that occurred came in the form of growing manufactured imports into Japan. But if you take a look more closely at the growth in manufactured imports, which the higher yen had made very cheap, most of it came in consumer durables and consumer nondurables. Imports of such goods registered a tremendous increase. On the other hand, while the pattern of import growth for manufactured imports showed consumer sensitivity to price changes, imports of capital goods did not show similar price sensitivity. They stayed just about flat. The statistical results show that the Japanese corporate sector was not particularly interested in buying a lot of foreign capital goods, but the Japanese consumers were just crazy about foreign imports and went into a major spending spree.

The other factor besides change in the incomplete structural change in the Japanese economy has been the incomplete change, I think, in the way that Japanese companies do business overseas. Statistics show that about 6.3 percent of Japanese production is now offshore. That's a doubling over a 10-year period. About 40 percent of that is in Asia; about 30.6 percent is in North America; and 17.9 percent in Europe. According to industrial analysis, by the year 2000, 10 percent of all Japanese production will be offshore. Actually this is an analysis of MITI.

A calculation by Japan's Center for Economic Research, looking at these statistics, indicates that this overseas production has replaced about \$28 billion in exports, about 10 percent of all cleared exports. And based on this, looking ahead at 1995, the center predicts that export replacement will rise to 20 percent by 1995, and will continue throughout the decade.

So corporate globalization is going on. And the problem is that in many cases a lot of these overseas plants are simply screwdriver assembly plants that do not procure a lot of products, a lot of parts and equipment, from local sources. One of the reasons for the huge

surplus of Japanese trade with Southeast Asia is quite simple: direct investments into manufacturing resources there indicate that there is a growing market for Japanese goods in these countries. Capital equipment and parts. In fact you could make a case that Japan's surplus with the Southeast Asian countries is in effect Japanese companies trading with other Japanese companies.

Until the Japanese corporate sector begins to localize, to procure more parts locally, to procure more parts from third country sources, that kind of imbalance will occur. It has occurred to a certain extent with the United States. A lot of capital goods coming here go to support Japanese manufacturing investment. What about foreign firms in Japan? Here again, I think, the structural problems as well as some market problems have made it very difficult for American companies and other foreign companies to make progress in the Japanese market.

MITI surveyed over one thousand firms in fiscal 89 and discovered that although these companies, these foreign firms, in Japan, operating in Japan already, had more than doubled their R&D expenses over a 2-year period of time, there had been no marked increase in market share of foreign capital enterprises in Japan as a whole. This kind of trend, hopefully, will be corrected over time as the structural changes continue to occur, but as we find in the SII process, a lot of the business practices of large corporations, a lot of the regulatory barriers, are still there and have to be addressed.

The other problem is that U.S. investments in Japan do not necessarily mean that U.S. exports are going to follow. In fact, most American companies may find it more profitable to manufacture in Japan and out-source either from within Japan or from third country areas. This is true of plants, this is true of some of the distribution sector investments that have occurred. One example is the Toys-R-Us venture which went into Japan and opened up 10 or more stores. Most of their stores were probably extremely successful in Japan as toy department stores; there is really no competition. But the sourcing for almost all of their toys will not be the United States, it will be Nintendo and many Japanese companies and a lot of Japanese factories overseas in Southeast Asia. The other problem, and this is my final remark, is that our economy may be approaching a level of interdependence with Japan that simple solutions may just not work. We may have to continue to focus on very comprehensive and sophisticated solutions to problems.

Let me give you two examples. One is the example of ITC's (U.S. International Trade Commission) ruling placing punitive tariffs on a flat screen display, the LCD (Liquid Crystal Displays). On the one hand, it put on a very high tariff that makes it impossible for a Japanese company to ship LCD displays here and make a profit, but on the other hand it makes it difficult for American PC (Personal Computer) makers to use these components in their own products and still be competitive with Japanese PCs. On top of this decision there was a removal of the punitive tariffs on lap-tops at the conclusion of the semiconductor agreement, which has now made it cheaper now for U.S. lap-top makers to move their factories and production lines offshore and it made it cheaper for Japa-

nese PC makers to ship directly from Japan, thereby adding to the export figures.

As an example of how it's difficult to deal with the problem by a very simple means, the Fanic Company of Japan which manufactures robots last year could not get equity participation in the Moore Special Tool Company in Bridgeport because of national security considerations. This year I read in the press that Fanic has made a deal, a nonequity technological cooperation deal, with Moore which accomplished basically Fanic's original objective anyway, the joint development of special machine tools using Fanic's NC controls and software. So the upshot is that a lot of what is going to happen is no longer in the realm of policy or even retaliation, but may be decided at the business level and we may find that the results are sometimes somewhat startling. Well, this is rather complicated. Perhaps I could clarify some of the more vague areas during the discussion period. Thank you.

REMARKS OF CLYDE PRESTOWITZ, PRESIDENT ECONOMIC STRATEGY
INSTITUTE, WASHINGTON, D.C.

Mr. PRESTOWITZ. Well you can't imagine how pleased I am to hear about a lot of the progress in the United States-Japanese trade situation and let me tell you why. I came to Washington exactly 10 years ago to join the Commerce Department as a trade negotiator and I remember very clearly at that time talking to then Secretary of Commerce Malcolm Baldrige about the job. I at one point asked the Secretary what my responsibilities would be if I joined the Commerce Department, and he said, well Clyde, your job would be to reduce the trade deficit. At that time the trade deficit overall was about \$28 billion, the trade deficit with Japan was about \$8 billion, and everyone said "it's insupportable." Congress was threatening all kinds of terrible legislation, business was up in arms threatening trade cases, and the general consensus was that we simply could not maintain, it was politically unfeasible to maintain that level of trade deficit, and particularly with Japan. Just absolutely impossible. We said the Japanese are going to have to do something; they're going to have to change or else.

I then asked the Secretary what my salary would be and he gave me a figure which was well below what my wife and kids had become accustomed to, and I mentioned that to him and he said not to worry. He said he was a businessman and he understood entrepreneurial spirit and so he said the Commerce Department would pay me a bonus, 10 percent of the amount by which I reduced the trade deficit. By 1986, I owed him \$16 billion and so I'm gradually working off my debt to the Commerce Department and I hope that we get the dollar down and that the yen is not undervalued, it goes to zero, and I can get out of debt. There is another story that I heard recently, a story told by a professor at MIT which I thought captured what I think in a sense is the essence of the United States-Japan relationship. This is a story of a climber who is scaling a vertical cliff and just as he's about to put his hand over the top he slips and begins to fall. It's a thousand feet straight down into the rocks and the water. And he's flailing around trying to grab something and finally happens to hold on to a protruding

root from this sheer rock face. He's hanging by one hand; he knows that he can't maintain this grip very long; has never been a particularly religious person but this is an extreme situation so he looks to the sky and says is there anybody up there? And to his other amazement a huge voice booms out, "yeah, what do you want?" And the climber says "what should I do?" And the voice says jump. And it's a thousand feet straight down into the rocks and the water. The climber looks back at the sky and says, "is there anybody else up there?"

The topic this morning has to do with the costs and benefits of growing interdependence, and I'd like to address the topic, particularly from that point of view. Lionel Omer, the former Under Secretary of Commerce used to carry around in his wallet a clipping which he would often read at meetings like this, and the clipping I wish I had it and I don't remember the exact wording, but the thrust of the, it was a newspaper clipping, the thrust of it went something like this. The negotiations had just been concluded in Japan between the United States and Japanese trade negotiators, great progress had been made, a number of sectorial issues had been successfully concluded and in a very positive tone. And Lionel would read that whole clipping and the audience would have the impression that this was a clipping from yesterday's newspaper. And then he would give the date, I think it was January 2, 1902, or something like that. I'm always reminded in this discussion of Tal-lyrand's famous comment, "plus ca change, plus ca meme chose". . . "the more it changes the more it stays the same".

There is the ongoing series of discussions and negotiations that take place between Japan and the United States, but not just the United States, Japan and Europe, Japan and Korea. I was just in Europe last week at the European Parliament and spoke to a number of the people who have been negotiating the auto deal between Europe and Japan and their commentary is very much the same kind of discussion that we're having here this morning. And typically the discussion takes place in terms of some specific negotiation and progress in that negotiation, and of course there is still more to do but essentially the tone is that there is some continuum along which Japan is moving, and ultimately you will arrive at a point which implicitly would be satisfactory to those of us in the West.

SII: I remember in 1982 the hot issue of that time was machine tools, and as some of you may remember the famous Houdaille case. Actually it was section 103, an arcane section of the tax law, that the case originally was filed under, but it was handled essentially as a section 301 case. The resolution of that was the President finally rejected the petition of Houdaille but as a consolation prize the President directed then-U.S. trade negotiation Bill Brock to enter into discussions with Japan about the structure of Japanese industry and Japanese industrial policy. So in 1983 we had a first round of talks known as the Industrial Policy Dialogue in which U.S. negotiators and Japanese negotiators talked about structural issues, industrial policies, administrative guidance, and so forth. Those talks lasted about a year and they were concluded and there was a declaration of success and progress. They were then followed within another 6 months by the structural dialogue.

The structural dialogue was carried on at the behest of then Secretary of State Shultz. Interestingly, the later talk involved more or less the same people on the Japanese and American sides; I think they were using more or less the same briefing books that had been used in the industrial policy dialogue. And again the topics were industrial policies, administrative guidance, distribution system, antitrust laws, and so forth. They were concluded after about a year, and again called a success with the usual announcement of change and progress. Then of course, these talks were succeeded by the Structural Impediments Initiative, also discussing the same topics by more or less the same people, and I dare say the same briefing books. Now this is not to say there hasn't been change. The big store law has been altered in some ways in Japan. The Japanese Torihiki Iin Kai, the FTC of Japan, has altered some of the guidelines on antitrust and they have increased the penalties from something like 2 percent of sales to 6 percent of sales. So it's not to say there hasn't been change. But the question is whether anything fundamental has changed or is changing or will change; anything fundamental about the issues or the phenomena that seem to give rise to a continual series of issues between the United States and Japan.

Someone mentioned that we are in a lull at the moment. I think that's the right way to describe it. The history of our relationship with Japan, at least as long as I've been involved with it which is now about 25 years, is that we go through periods when things are quiet. Typically in those periods we say finally we've resolved all the issues and then 3 or 4 months after that there is another spate of issues and things get hot. And we negotiate and then we go into a lull, so at the moment I would say it's correct that we're in a lull. The question is, does that mean that anything fundamental has been changed. And I think all of you have heard me enough to know that I'm going to say I don't think so. And I think the reason actually is something that Fred Bergsten alluded to. He mentioned this competition between different capitalisms, and he used the term noncapitalist market economy.

A brilliant official at the Ministry of Finance in Japan has written a book in which he uses that phrase to describe Japan's economy. He identifies Japan's economy as a noncapitalist market economy and talks as Fred said about corporations being run by stakeholders rather than shareholders and moreover it talks about the broader social imperatives that impinge more strongly on the Japanese economy than on the economy of many western countries. And interestingly, he does not make the division between Japan and the West; rather he makes a division, he points out that it's the Anglo-Saxons, the Brits, the Americans, the Aussies, the Canadians, who are capitalist market economists and it's the Japanese and the Germans, and to some extent the French and others who are noncapitalist market economists. And he notes similarities in the structure of Japan and German and other places.

But I think it's an absolutely fundamental point because of course change is always taking place; of course Japan changes, all societies change all the time. But all societies, also have certain continuities. You know Chinese society has changed enormously over the past 3000 years, but I bet you wonton still stays pretty

much the same as it did 1,000 years ago. There are continuities, and so I think the question we have to look at in the United States-Japan situation is what are the continuities. And I would argue that there are two or three, or possibly three, that are very important. One of them is captured in this great phrase that Mike Boskin denies ever having used, "potato chips, semiconductor chips, what's the difference, they're all chips." As I say, Mike denies that he ever used that phrase but it's too bad that he denies it because it really captures the essence of the debate very succinctly. And I can tell you that if he didn't use it, I myself was present in the room when Dick Darman at the height of the debate in 1985-86 over the semiconductor issue, made the comment "why do we want a semiconductor industry in the United States? We don't want to pick winners and losers; we don't want to have an industrial policy," said Dick, "if our guys can't hack it let them go." It's inconceivable that a Japanese Dick Darman would make that comment. It's inconceivable that Mike Boskin's counterpart in Japan would even have to deny making the statement because no one would ever believe that he had made such a statement. A fundamental divide between the United States and Japan is that our economic philosophy asserts essentially that it doesn't matter what we make; that what we make is determined by whether we have sunshine or we have rain or whether we happen to have a cold climate or a warm climate, whether we have iron ore or lead, and we should be happy with what God gave us and make what we can and fix our exchange rate and our interest rates properly so we can sell what we can make and not worry about it.

Japan doesn't believe in that. I might add many other countries don't either. Japan believes that an absolutely fundamental essential part of economic policy is being sure that you have an optimum industrial sector and that you make certain key things. And I don't mean just a few key things but a lot of key things. And hence Japan's Industrial Structure Council, hence Japan's industrial policy, and hence a broad and deep consensus in Japan that Japan needs to be in a leading position in a broad range of industrial and technological activities. That difference gives rise to a large percentage of the trade frictions between Japan and other countries because Japan's thrust in that direction begins to impact on important industries and technologies in other countries, it begins to displace the ability of other countries to participate in those industries, and gives rise to pain and suffering and response and negotiations.

A second really important factor is that a big part of this noncapitalist market organization is relationships. Business is done, life is lived in Japan on the basis of relationships to an extent that is difficult to comprehend in a western society. The keiretsu structure is about relationships. The notion that somehow by applying anti-trust policy or just changing the penalties on collusion in Japan we can somehow prevent the closed nature and the cohesive collusive characteristics of the Japanese industrial groups is I think fatuous. This is something that grows out of very deep characteristics of the way Japanese think business should be done. And it again runs counter to very deeply ingrained notions here about the way business should be done. It's not something even if you wanted to

change that you could easily change. And in my own humble judgment, it's really silly for the United States to be making some of these requests.

The third point I guess I would make is that the Japanese relationship of doing business and organizing business is also related to the tradition of administrative guidance, in which administration and the execution of policy and law is done in formal ways by leaders who have tight relationship with business and who have a great deal of discretionary power which, allows them to apply policy flexibly and discretely.

I think the best illustration of not only how this works but how it probably is not going to change in substance—it may change in form, but not in substance—is the financial scandals that we've been seeing in the Japanese financial markets. It's fascinating that the Ministry of Finance knew that the Japanese securities companies were making paybacks. In fact, my friends in Japan tell me they even directed it in some instances.

It's fascinating that through all this scandal, no one has been accused of violating a law, no case has been brought. People have resigned; I guess Hashimoto is going to resign after the bank conference. But really when you kind of put a magnifying glass on it and say what's there, nobody is, really. As for changes—they're not going to create an SEC. The same Ministry of Finance bureaucrats who have been administering the securities industry are going to continue to do it. Some of them might move. The same amakudari system is going to continue. It's really not going to change.

Now, again, that really runs counter to one of our traditions. And Fred said that we're going to have a competition between these two capitalistic systems. I would amend that a little bit and say we have a competition between these two systems. It's been going on for quite some time and the evidence indicates that the U.S. system, the capitalist market system, is not doing very well. The evidence of not doing very well was pointed out by the previous speaker, and he pointed out the flat panel situation. There is another situation which is even more incredible than the flat panel case itself; some of you aware that an NEC subsidiary, I've forgotten the name of it, JAEC or something like that, has been servicing Iraqi missiles illegally under CoCom regulations. Now you remember that as a result of Toshiba case, the United States impressed upon Japan the necessity to deal harshly with any Japanese companies which would violate CoCom and deal with the enemy so to speak. So Japanese presumably took that to heart, and it came out. This NEC subsidiary has violated the law; they were servicing patriot missiles, not patriots but whatever they were, illegally for the Iraqis. So now MITI has decided by jove we've got to hit them with the full force of the law. Great.

It turns out that this same company supplies important components of avionics systems to Honeywell; Honeywell takes those components and puts them into a larger avionic system and sells them to Boeing. And moreover, the Honeywell system has flat panels in it from Hosiden. So now it turns out that Honeywell can't make the avionics and Boeing can't make the airplanes because the United States has insisted to Japan that they have to

punish companies that service Iraqi missiles. This is interdependence. This is an aspect of interdependence.

Very often in these international conclaves we talk with something close to euphoria about growing interdependence, the global market, the world economic village. Well there are some down sides to interdependence, because in an interdependent relationship there is a power element. And it is always better in an interdependent relationship—desirable—to be on the strong side of the power element of that relationship than on the weak side. And the salient point for the United States in this discussion about whither United States-Japan is that the United States is increasingly on the weak side of power element in this interdependent relationship. And that will give rise to continuing tension and as Fred pointed out, in a world in which that tension is not subordinated to a larger geo-political interest on both sides, it could become a very disturbing and important factor. Thank you.

Mr. BERGSTEN. Could I ask Clyde before he sits down to clarify his last story? Why is it that the punishment of JAEC for supporting Iraqi missiles winds up denying the products to Honeywell?

Mr. PRESTOWITZ. Because the punishment is they can't export. It hits their, JAEC, export that they are prohibited from exporting certain products.

Mr. BERGSTEN. But that didn't need to be the punishment.

Mr. PRESTOWITZ. No, but look Fred. MITI is sticking it in our eye. MITI is saying okay you guys, you want us to hit these companies, by jove, let's hit them.

Mr. BERGSTEN. But if we hit them we should hit them with two points and the second is to keep selling to us. Did we ask them to deny the sales to us? You say why did it have to come out right away? The United States has the clout to get the Japanese to block the sales to Iraq, why didn't it have the clout to keep the sales coming to Honeywell?

Mr. PRESTOWITZ. I'm not sure. We'd have to go back, and we can do this if you like, and let's pursue it; it's kind of an interesting case.

Discussion

Mr. NANTO. Thank you, Clyde. We have about 15 minutes for questions and answers. Could you please identify yourself and your office. The questions can be addressed to the panel in general or to a specific person on the panel.

Mr. ALFRED REIFMAN, CRS. Clyde Prestowitz just said that the United States is not doing very well and Japan is doing very well. In everything I read, the fact that we're not doing well has nothing to do with international trade, our exports are growing and the strongest part of our economy. Similarly, Japan is doing very well; it's doing so not because of its exports which is a less dynamic part of the Japanese economy than it has been. Aren't we focusing on the anecdotes when we focus on all of these pieces of examples that have come up, and avoiding what are the real domestic problems of the United States and Japan? Anyone who wants to answer.

Mr. PRESTOWITZ. When I said the United States is not doing very well, I wasn't thinking of it in a narrow sense of just exports or trade. I mean as you know, these are very broad questions. But I

think on almost any measure you want to look at, our productivity growth is less than Japan's; our ability to commercialize technology is less than Japan's; it's true that in a very dismal economic picture the one bright spot has been growth of U.S. exports but even there, I think it's fascinating. We did some work at our institute recently on the composition of U.S. trade specifically with Japan, and the fastest growing U.S. export items to Japan are scrap aluminum and logs and commodities. We actually have a growing trade deficit with Japan in high technology, various areas of high technology equipment. And so even as our exports rise, I haven't looked at this carefully, but I'm guessing that the terms of trade continue to go against the United States. Now, I would be the first to say that I don't think that trade is a primary factor.

I tend to see trade as a symptom rather than as a primary cause although I do believe that trade can be a primary cause in that if you are in a situation in which as a result of combination of somebody else's industrial policies and your own lack of response you get kicked out of important trading industries, then you just don't have things to export. But surely the issue we are talking about here is not the narrow question of United States versus Japanese trade policies. We're talking about, I think Fred said it, we're talking about competition between two different kinds of economic systems. And that includes investment policies, fiscal monetary policies, technology policies, education policies. We're talking the whole broad range of the economy. And anywhere you look at it, the United States is not doing well.

Mr. BROOKS. During the structural talks, the United States basically admitted and Japan admitted and put it into the final report what they felt were the weaknesses in their economies, and for the United States it was mostly macroeconomic and we promised to make adjustments like trimming our deficits and improving our corporate competitiveness and the educational programs, training, even making some changes in our antitrust law.

A lot of the Japanese suggestions were actually taken as to what they felt were the problems in our economy. The problem now is to implement our promises. The Japanese, too, admitted in this forum that there were structural problems in their economy which were preventing their system from harmonizing with the rest of their system. And in effect, the agreement, if implemented faithfully on both sides, would harmonize the two economies, and speed up their integration. Whether they will be completely implemented or not depends an awful lot on the follow-on process which is occurring right now. So the results have yet to be tabulated. It's awfully easy to dismiss a lot of what was promised as just verbiage, but in effect some of the things that Japan has promised they have delivered.

Mr. ROBERT GREELY, Chase Manhattan Bank. I'd like to address the question to Mr. Brooks. It looks again this year as if Japan is heading for another huge trade surplus. But strangely this time, it is not affecting the United States' trade deficit. You made reference to Japanese moving manufacturing offshore. Has anybody tried to actually quantify how much of the growing trade deficit between the United States and Southeast Asian Countries, such as Thailand and Malaysia, is in fact Japanese manufacturing from a different direction?

Mr. BROOKS. The quantification is still premature. But there is some evidence though I do have some statistics so I could dig them out which shows reverse imports. And it shows that in countries where Japan has put a lot of investment, then immediately there is a corresponding increase in exports and a corresponding increase in imports based on those foreign affiliates. In other words, a Japanese factory in Southeast Asia needs Japanese capital equipment and Japanese parts to get started. In turn, a lot of the output of that can be shown through reverse import figures which MITI tabulates is going back to Japan. Of course some of it is domestically used in those countries and obviously a lot of it may be going to the United States and to the EC. So there is some preliminary data.

The other thing that I would say, and this is sort of speculation, is that as long as Japan's investment, direct manufacturing investment, continues to grow at a healthy pace in any economy, the exports to that country from Japan are likely to take off for a while as they put the equipment in, get the parts into those plants. What we would like to see, and this is very iffy, is that more and more of these factories as quickly they mature begin to source locally. And this of course is what most countries want. I think you see a lot of that in the EC where there are local contents laws. You may find, for example, a Japanese factory sourcing 80 percent locally. But where there are no local content laws or there are other ways of getting around it, you probably won't see that kind of local sourcing. So a Japanese plant overseas may help create jobs etc., but it does not necessarily mean that that's going to balance the trade relationship. It's much more complicated.

Mr. BERGSTEN. You asserted there is a big increase in U.S. trade deficit to Thailand, etc. I don't know where you get that. The numbers through July show the U.S. deficit with the NICs down almost 50 percent in 91 over 90. And in the rest of Asia, excluding the PRC, but you weren't probably talking about the PRC in this case. Well the PRC was up \$700 million but in the NICs it was down \$4 billion which is close to 50 percent, and with other selected Asia it was unchanged.

Mr. GREELY. I'm not talking about the NICs, but about Thailand—

Mr. BERGSTEN. In the category "other selected Asia", which includes them, there is no change.

Mr. GREELY. In the investment in China, particularly in Guangdong province, Japanese investment, is going into Hong Kong to a large extent.

Mr. BERGSTEN. The imbalance with Hong Kong is down 75 percent in 1991 over 1990.

Mr. GREELY. The point is in Guangdong province.

Mr. BERGSTEN. I have a few facts, I thought you'd like to use them. Because the U.S. trade deficit is down enormously this year. That's why you raise the question and say it's up with somebody, I don't think that's right.

Mr. PRESTOWITZ. We've done some work on this, too. And if you are looking at 91 over 90, yes, the whole U.S. trade deficit is down. But you mentioned Thailand, and we just happened to have looked at Thailand too. Japanese investment into Thailand began to sky-

rocket in 85. And the pattern that you see is very interesting. Japanese investment skyrockets in Thailand and Thai imports from Japan go through the roof. Thai exports back to Japan climb somewhat but Thai exports to the U.S. take off. It's very difficult to track out, but we've come up with some preliminary figures which indicate that what you're saying has some truth in it. That is exports of some consumer electronics products that used to come from the Japan to the United States. The parts now go to Thailand to be assembled and they come from Thailand to the United States. The correspondence between the numbers, the drop in the U.S. imports of those products from Japan and the increase in imports from Thailand and some other places, the numbers track fairly closely.

Mr. NANTO. Did you have a followup on this?

Mr. KEVIN KEARNS, Economic Strategy Institute. I'll be on the panel this afternoon, but I've done some work on this point. And it's a very important point because what's happening is with the global Multinational corporation which Mr. Brooks mentioned earlier. Japanese corporations are locating all over the world and they are skewing trade patterns. And it is very difficult, it's becoming increasingly difficult to use trade deficits as a measure of national competitiveness. Take the trade deficit with Japan that was \$57 billion 3 years ago and now its 41, its down \$15 billion in 3 years. American firms must be on their way back. The reality is more complicated. We know, for instance, that the trade deficit with Japan in electronics has dropped \$4 billion from 87 to 90. We also know that the big non-Japanese electronics companies brought in about \$3.7 billion dollars worth of electronics from Mexico and Southeast Asia. These imports show up in the other countries accounts.

If you, just look at the face of the figures, as Fred Bergsten says, it's impossible to tell. The U.S. trade balance with Thailand may be in surplus or may be in deficit forever, but unless you aggregate or disaggregate that surplus or deficit and look at what portion is Japanese, just because the figures are up and down doesn't really mean it. The Japanese value added in these electronics products is about 80 percent. Thai value added is about 20. So has the trade deficit with Japan really fallen \$4 billion? No, it's fallen about 20 percent of that most probably. And we need better measuring tools to get at these sorts of things so we can tell who is openly controlling trade and who is benefiting from it. I think it's a very important point.

Mr. BERGSTEN. I agree with the importance of doing that kind of analysis, but be clear what you are analyzing. Then you're sort of looking at the global trade position of Japanese firms and that's certainly worth looking at. But then on the other side of that equation you want to put the global position of show U.S. firms. And we know from all the studies that have been done, they need to be updated, but many have been done that U.S. firms have maintained a much better market share than the U.S. economy defined only in terms of trade flows across our borders. So I think you're right. A big study of Japanese firms versus U.S. firms on a global basis would be a good thing to do. Then you'd have to interpret what

that means in terms of United States and Japanese economies and that's the famous "who is us?" question and all that.

Just one more point because it is relevant. The last time a study was done of the global market shares on all U.S. firms, that was the Kravis-Lipsey study of 1987, it showed there had been no diminution despite, at that time, the big decline in the U.S. trade balance on a purely geographic basis. Sure, there would have been some downs, some ups. I only want to say that if one wants to look in the aggregate, you have to make that kind of calculation. You still come back to the point Clyde made, you worry about giving sectors, fair enough. But again, think of that one is a logically symmetrical hole as well.

Mr. NANTO. We're rapidly running out of time so let's take just two more questions. Martha first, then the gentleman in the front.

Ms. MARTHA HARRIS, National Research Council. This morning, I guess the major theme was the interdependence and presumably with interdependence between the United States and Japan there are possibilities for tremendous benefits to the U.S. side in terms of capital, and presumably technology transfer, and what not. I'd like to ask the panel about a tough question that seems to be cropping up here and there and that is whether or not there, is any evidence that there is some explicit conscious strategy to limit either exports of technology or capital from Japan to the United States. We've seen recent reports, for example, in regard to Japanese components exports to the United States. This would make for a big difference in the way you look at the interdependence equation if this evidence were really wide spread. I'd like anyone to comment on that.

Mr. BROOKS. The difference is whether it's the practices of individual companies or whether it is some kind of grand strategy. I don't think that most of the cases are actually plotted in the Cabal under Mt. Fuji. But there is I think a pattern of Japanese direct manufacturing investment overseas, that some break, but I think it's a general pattern that you don't transfer your best technology overseas, you keep it in house. And that as you create new higher technologies, you keep those in Japan and then move the cast-off technologies offshore. We constantly hear from the Asian countries complaints about technology transfers. They are never adequate; they are always asking the Japanese to sell them technology or transfer technologies that are more appropriate to what their growth needs are. So I think there have been some studies by Professor Kojima that the U.S. pattern, of direct investment or technology transfer is to give everything away offshore; the Japanese are rather stingy. So based on that, I would say there is a general pattern but I would not think there is any concerted effort to deny technology for the purposes of national strategy.

Mr. BERGSTEN. Does IBM give its best technology to Apple? (Now they might.) It's a serious question. Because most competitors try not to give their best technology to their competition. Now comes the important question of Japanese case where you are trying to get in. If you can't get in you may have to sell it. And that's the licensing and the give-away points you made.

Mr. PRESTOWITZ. There is another important point and that is to get back to the relationship question. I think what both of you are saying is correct. Go anywhere in Southeast Asia and the Asians

will tell you that it's much easier to get technology from the Americans than it is from the Japanese. And it's also true that it's a natural. Obviously, if you're a company, an IBM or Apple or whatever, it's natural that you don't want to give your best technology to your competitor, but that's not the issue. You have two other problems. If you are a U.S. semiconductor manufacturer you don't expect NEC to give you their best technology. But you might expect that a Japanese stepper manufacturer is going to sell you his most advanced stepper. However, if the stepper manufacturer in Japan is part of NEC keiretsu, he might not sell you his most advanced stepper. And because these relationships in Japan are so pervasive, they have the effect of inhibiting technology transfer abroad under circumstances where we would expect it to take place because we're imposing the Western auction market model on that relationship and the Japanese are imposing the Japanese keiretsu relationship model on the relationship. Second, and very importantly, the Japanese have a long history of what we would think of as collusive behavior in their trade associations, the EIAJ, the Machine Tool Manufacturers Association and the Steelmakers Association of Japan, all of them have a long history of fixing prices and export cartels and so forth. In their relationship with countries like, all you have to do is read the *Nihon Keizai* (leading financial newspaper) every day, and you see stories where the Japanese semiconductor manufacturers or the Japanese VCR manufacturers have talked about what technology they can transfer to Korea. And it crops up a lot in Korea because the Japanese are conscious that the Koreans are trying to imitate them. And so the whole game here is how the Japanese kind of keep the Koreans under control. And one way to do it is to all agree that we will all only give the Koreans so much but no more. And given this history of the ability to get together and kind of set terms and agree there is certain balance we all won't go beyond. It's much easier for them to avoid that kind of transfer outside the country than it is in the United States, where you don't have those traditions.

Mr. NANTO. There is incidentally a GAO report that just came out that looked at this question.

Question. I'd like to return to one of Fred's earlier remarks about Congressman Gephardt's remarks to the Institute in which he drew, I gather, a major conclusion from one economic indicator. Just to follow up on that. Clearly the remarks of the panelist suggest the complexity of measuring and then drawing inferences from this increasingly complex United States-Japan economic competition relationship. American people, and maybe even Congress, are not nearly as well versed, and they may key on just a few indicators such as the bilateral trade imbalance. One very common economic indicator that hasn't been mentioned at all, to my recollection, is GNP or GNP per capita and trends therein. Can the panelists comment on projected trends in those indicators and whether you think if they were adverse, if the United States-Japan comparison was adverse in American terms, they would have political salience in terms of policy and legislation.

Mr. BERGSTEN. It's an interesting question. I know there is some concern about that in Japan. If you do projections out 10 to 20 years, and we've done them in a number of contexts, and even on a

Panel 2—The Global Economic Power Triangle: The United States, Japan and Europe—Opening or Closing System?

JEFFREY E. GARTEN, *the Blackstone Group*

ROBERT Z. LAWRENCE, *Harvard University*

BRUCE STOKES, *the National Journal*

SHINZO KOBORI, *C.Itoh & Company*

RAYMOND AHEARN, *Congressional Research Service*

OPENING REMARKS OF RAYMOND AHEARN, SPECIALIST IN TRADE RELATIONS, CONGRESSIONAL RESEARCH SERVICE

Mr. AHEARN. Thank you, Rich. Clearly, the end of the Cold War and more even distribution of economic power raise a number of questions that will be the basis for this discussion. Fred Bergsten pointed out in the first panel that the Cold War actually provided the United States, the European Community, and Japan with a common enemy and a common threat that did help suppress economic conflicts since World War II. Conversely, he argued that the end of the Cold War likely means there will be an increase in economic conflict among the big three in the future. I think that premise can be questioned. For example, he mentioned the Uruguay round and said that U.S. negotiators wouldn't be pushing as hard on the Uruguay Round for the past 3 years if it hadn't been for the demise of the Cold War. An alternative explanation could be that one former U.S. Trade Representative, who had a deep concern about the agricultural issue, is primarily responsible for the U.S. negotiating strategy. It might not have much to do with the Cold War, but I'll leave that as an open question. Second, the first panel did suggest that there is a great deal of tension between the interdependence of the world economy on the one hand and different national priorities, policies, and systems of Japan, the United States, and the European Community on the other. The question is how can you resolve or better manage that kind of tension.

And the third issue, is how we can revitalize or even maintain a globally oriented international economic system when the EC is preoccupied with internal reform, with what's happening in Eastern Europe, the Soviet Union, and when Japan remains Japan.

For a first cut at discussing some of these questions, we will turn to Jeff Garten. Jeff is currently Managing Director of the Blackstone Group. He's been in the investment banking business since 1979; previously he served in the Nixon-Ford-Carter administrations, both at the White House and at the State Department. He's a frequent contributor to Foreign Affairs, the New York Times, and is currently writing a book on the triangular relationship. I think the most recent piece that he has written that I have seen was entitled "How I was Framed by the CIA" which is an account of a seminar he attended in Rochester, New York, and is the topic for another seminar. Jeff, the floor is yours for about 10 minutes.

REMARKS OF JEFFREY E. GARTEN, MANAGING DIRECTOR, THE BLACKSTONE GROUP

Mr. GARTEN. For some reason my wife has always assumed that I was a CIA agent and never told her. And when all this happened with the article that was mentioned, she made me promise that I

would never again go to a conference or seminar where there was a microphone or any possibility of something being recorded. So when I saw these, I got a little nervous. As I see it, the purpose of this panel, really, is to broaden the discussion a little bit beyond the United States and Japan and beyond strictly economic issues. And so what I would like to do is to focus on what's been called the triangular relationship, but I'd like to define it from the outset as not the United States, Japan and Europe, with Europe in a sense being an abstraction, but to focus on Germany. This is integral to my view of the world so I'd like to just say a word about that by way of introduction.

A few years ago it would have been much more difficult to talk about Germany aside from the European Community, and maybe even a year ago on the eve of unification and in the midst of all the statements that Chancellor Kohl and the Foreign Minister were making about Germany's obligations to the European Community, it would have been difficult then I think, or more controversial to talk about Germany aside from Europe. But my contention is that today and tomorrow and the next 10 years, this is going to be the fact that the European Community may become somewhat of an economic unit as far as Western Europe is concerned, but as a political entity, as an entity which can make political decisions or decisions relating to security, I don't think we're going to see that; in fact I'm sure we're not. And I think we will see an increasing assumption on the part of Germany of influence.

It can be argued whether this is deliberate or whether this will be by default or whether this will be out of paranoia, a perceived need to fill a vacuum or to stabilize what I think is going to be continuous chaos on Germany's eastern side. But however you come at it, the key triangular elements relationship in terms of who's making the decisions and the real driving forces, in my view, are Germany, Japan and the United States.

Now I think that in looking at the next several years, one of the real pitfalls is to make an analogy between the kind of relationships that we had during the Cold War and the kinds of relationships that we're going to have in the future. Americans, especially, tend to think of things in black or white. I think the experience with the Soviets is that somebody is either our enemy or they are an ally. But what we face now is a much more ambiguous situation where the terms enemies and allies just may not have much relevance because in our minds, at least in the American mind, this connotes good guys and bad guys, black hats and white hats. But in looking at Germany and Japan, we face something totally different. Without question there are going to be areas where there is going to be a strong amount of cooperation, but in other areas, there is going to be an intense level of friction. And just to simplify things, if I had to state on which side of that balance we're going to be I would say it's on the side of friction.

It is an oversimplification I think to say that these countries are either going to be friends or enemies because they are going to fill an ambiguous category that we have not really come to grips with. I just want to reel off some of the areas where I think there is going to be a substantial amount of friction. And I'm not even

anticipated in a number of CRS seminars. Robert, it's a pleasure to have you back.

REMARKS OF ROBERT LAWRENCE, PROFESSOR OF INTERNATIONAL TRADE AND INVESTMENT, THE KENNEDY SCHOOL, HARVARD UNIVERSITY

Mr. LAWRENCE. Thank you very much. My perspective is going to be somewhat different. I'm going to deal with two issues. The first is in the trade area, the question of regionalization. How should we think about the regional arrangements that are emerging around the world? And the second concerns the political effects of different economic structures which is a theme that we've already touched on earlier this morning.

First, on the issue of the regional arrangements, there is a view which argues that what we're seeing is the repetition of the 1930s, in a sense a process of inevitable fragmentation that's taking place in the world trading system and more broadly in the world economy. People point to EC 92, they point now to the emergence of the North America Free Trade Area, and they argue that Japan in a more subtle and less visible way is developing a bloc in Asia. If you look at the history of the 1930s, you do indeed see what Charles Kindleberger called the disarticulation of the world economy, a fragmentation process; another feature of the 1930s is essentially a leaderless world economy. An American economy which has emerged as a major global player in terms of its resources, but which is not taking responsibility for the global system.

There are those who see history as going to repeat itself looking out into the 1990s. I believe fundamentally this view is incorrect. I think in fact properly handled, regional arrangements can be viewed more as building blocks of an integrated world economy rather than stumbling blocks. The way I look at it is first to examine what the GATT system was all about. And here I would introduce a concept of what I term shallow integration as compared with deep integration. The GATT system essentially was a view of the world economy that was quite appropriate for the 1950s and 60s in which we still had the legacy of the 1930s with very, very high tariff barriers preventing trade between the economies. And essentially what the GATT is trying to do and has succeeded in doing is firstly bringing down those barriers at the borders. We've removed tariffs virtually as an inhibitor of trade. We've also moved beyond it in some areas in the GATT. But by and large, if you listen to what's being asked for in the GATT system, it's things like national treatment.

National treatment says however you treat your domestic firms so you should treat foreign firms within your economy. In other words, we don't try to regulate how you treat your domestic firms. We are not trying to harmonize how different countries treat their domestic firms, simply don't discriminate.

The GATT system essentially has emphasized border barriers and nondiscrimination and has been directed against practices which are explicitly discriminatory against foreign firms. I think that that process was fine and important, but has not gone nearly far enough to deal with globalization as we see it today. I think

there is an emerging recognition throughout the world that to deal with globalization we have to move beyond the shallow concept of integration towards a much deeper form of integration, towards a reconciliation somehow, maybe through harmonization but at other times simply through mutual recognition, but a reconciliation of divergent national practices.

That's what we're getting in EC 92. That's also what we've seen in the SII talks, the Structural Impediments Initiatives talks between Japan and the United States. The message there is it's not sufficient to simply remove border barriers, what we need is this deep integration. And that's what I see as occurring essentially in EC 92. Those nations recognized that the differences between them had become too great to be tolerated in a globalizing international situation. And so they are working hard at changing those.

If we look at the NAFTA agreements, what's striking there is the degree to which they too reflect conflicts of deeper integration, certainly much deeper integration than you ever saw in the GATT system. In this regional move with respect to the Mexicans, what it's about is saying to them, "look you can have access to the United States market, but at a price. You have to assume some major obligations, in fact obligations which are actually unprecedented for a developing country to assume. You have to agree to controls to your domestic industrial policies. You have to agree to controls in the environmental area. You have to agree to intellectual property rights." In essence, and if we see it with the Canadians, the obligations related to investment, the plan is to move further and to deal with subsidies, but we're dealing very invasively with deep issues.

I would submit that it's impossible, to deal with these issues of deep integration effectively at a global level. That it is necessary to deal with them at a regional level where mechanisms of governance are more credible. The GATT in fact is not a credible organization. When a country, particularly a developing country like Mexico, says it's going to join the GATT, it's not taken by the rest of the world as a credible signal because GATT allows developing countries essentially special and differential treatment. While people may not think the GATT is credible, I think no one doubts the powers of the lawyers of Washington. And when you enter into an arrangement with the United States as a Mexico, you are taking a much more credible step and I think therefore it is a necessary step. Now what needs to be recognized is that in each case, because of the essential nature of these regional arrangements which are liberalizing in essence, the rest of the world is given major benefits. And that is very different from a regional arrangement, as in the cases of the Latin American arrangements of the 1960s where the purpose was to lower the barriers between your countries in order to enjoy some economies of scale and to exclude outsiders.

When Mexico agrees to change its intellectual property rights system, that transformation benefits all who want to sell in Mexico. When Mexico agrees to a constraint on its industrial policies in autos, that benefits all who want to move in and sell autos in Mexico. When Europeans agree to inhibit their domestic subsidies, not as much as we would like perhaps, but nonetheless more

than they would otherwise do, again these confirm benefits on outsiders.

In trade theory we know that we should view these regional arrangements ambiguously. They create trade on the one hand and they divert trade on the other. But we also know from trade theory that if a country actually is prepared, or if two countries are forming a regional arrangement are prepared to lower their barriers to outsiders as well as internally, everyone can be made better off.

What we're getting in the United States-Mexico negotiation is that the Mexicans have already paid up front. Mexico has already liberalized with respect to the world. Mexican tariffs have been brought down. So I think viewed in that context we can see a liberalizing initiative which confers benefits to the rest of the world.

I can extend this to the rest of the what's taking place in Latin America. Again, we're seeing a mechanism which is reinforcing an opening process. And so that's why I think we're not seeing a repetition of the 1930s. We are in fact seeing a process of deep integration.

The question is, of course, whether these regional initiatives will be compatible with one another. And that in my view is where the GATT comes in. If the GATT fails, I would agree that there is a much greater danger of a splitting apart economically of these areas. It is necessary if you pursue a multitrack approach to make sure that all those tracks are leading in one direction. You do need a parallel sort of process, but nonetheless, I think it is a critical one.

I would agree with what Fred Bergsten said earlier and that is that the United States, while pursuing a western hemisphere initiative can't stop there; that inevitably the United States is going to be led to invite the rest of the Pacific to join these open arrangements but therein lies the problems which we dealt within the earlier session. I think shallow integration is a nonstarter, particularly in United States-Japan ties and in the integration with the other systems, and therefore we come back to this whole question of how do we get deep integration on an economic sense between these two different systems of capitalism.

I do think that we have to examine the way in which Japan has emerged and I'll just touch on this extremely briefly. In my view, the real problem that we confront is that this alternative model in its essence and certainly in the way it has been applied in Japan is not compatible with deep international economic integration. And that is the great structural problem which Japan confronts. And I would disagree with those who said earlier that there is a Japan-German system and an American system. In fact, I think the German system is quite compatible with deep integration. Indeed we could ask ourselves the question why is it? West Germany has a greater amount of exports of manufactured goods than Japan does. And yet, we never have protectionist measures virtually taken particularly against Germans. Japan is thwarted at every turn. Why is that? Some would say racism. I don't believe that's the reason. The fact is that if you look at the patterns of German trade, you discover the reason. Let's take chemicals for example. Germany has exports of chemicals of \$50 billion. But Germany has imports of chemicals of \$25 billion. So the German pattern of trade has an ex-

tensive of intraindustry trade. Well think about the politics of that. If there is an American firm that gets upset about German exports, there is going to be another that has substantial exports to Germany.

If you look at Japan's trade in autos—\$50 billion of exports and \$5 to 6 billion of imports—a very different political structure emerges. And you can go down various aspects of the Japanese economy, and finally, I'll just mention one which has to do with foreign investment. The conclusion that I would reach is that the Japanese mode of development has not give Japan enough hostages. In essence, to have a stable political and economic relationship, a country has to have a lot of hostages, and that requires interpenetration.

Whereas foreign firms have 17 percent of total sales in the West German economy, foreign firms have less than 1 percent of sales within Japan. Japan has been opening its economy to foreign investment in terms of regulations and so on in the 1980s; but Japan's share of inward foreign direct investment of the world is no greater today than it was in 1973 when Japan was closed to the rest of the world. The total value of foreign equity in Japan today, about \$12 billion, is equal to the value of foreign equity in South Africa after the disinvestment process. So there is extremely small foreign participation in Japan. We're told anecdotes about the few success stories, but I think this has important political implications for Japan. It basically means that the lack of an open and interpenetrative market which is derived from that system's capitalism has severely weakened the Japanese economy politically. I'll end there. Thank you.

Mr. AHEARN. Thank you, Bob. Our next speaker is Bruce Stokes. Bruce is the Senior International Economics Correspondent for the National Journal. His beat has been United States-EC and United States-Japan relations, and he has spent a considerable amount of time in both Brussels and Tokyo. His reports are usually incisive and provocative, so we expect no less today. Bruce, please.

REMARKS OF BRUCE STOKES, SENIOR INTERNATIONAL ECONOMICS CORRESPONDENT, THE NATIONAL JOURNAL

Mr. STOKES. It's a little difficult to be provocative after the previous two speakers. In thinking about coming here, I was reminded of a trip I took to Japan in the Fall of 1989 where I was feeling very proud of myself to be at the new center of the universe in terms of what was happening in the world. And I got to Japan and happened to turn on the radio the next morning and found out that the Berlin Wall had fallen overnight, and I was kicking myself for being on the edge of the universe where nothing was happening when really the important place to be in the world was Europe. And I think that we will increasingly, all of us as we address these issues, find ourselves bouncing around the world almost like a ball in a pinball machine because increasingly it's going to be impossible to differentiate the problems we all try to wrestle with in our daily work; bilateral problems are increasingly going to become tri-lateral dilemmas that don't offer themselves up for easy solutions in the old bilateral sense. We've talked about trade imbalances

among the three super power areas so far. And the fact that we've begun to see a growing EC imbalance with Japan and we see now growing a U.S. surplus with the EC. And I would predict that what we're going to see is a result of that.

As the Europeans learn and sharpen their trade laws against the Japanese they will eventually turn them on us. And how that affects us in a policy sense is we're already seeing. The major U.S. multinational corporations in the GATT context have begun to argue to change the dumping laws because they now are very afraid that the dumping laws will be used against U.S. companies. And this is in part because of the way they may be used against U.S. companies in the Third World; it's also I think in part because of fear that these European laws may be used against the United States. And they are attempting to avoid that problem that they see coming down the road.

There is a particular problem in autos that we've alluded to. There is this new EC-Japan agreement on automobile trade which effectively limits Japanese market share in the European market through 1999. The Europeans, of course, argue that this is really not a limitation on the Japanese market share since it is allowed to continue to grow. In fact the agreement harmonizes barriers that each country had against Japanese imports, but effectively from an outsiders point of view, it's an imposition of a cap on Japanese market share. The Japanese auto makers have perceived that, because they have already challenged the agreement and have begun to question what was agreed to and what was not agreed to. And I think that we will see, initially of course, a diversion of trade. Automobiles that cannot be exported to the European market in a recessionary period, for example, could very easily end up in other markets. Now the question is whether they will end up in this market. I think probably that's not the issue. It's unlikely that Toyota would ship cars against itself into the U.S. market. But it is entirely possible that if we see, for example, the Latin American economies begin to pick up rather rapidly in the mid-1990s as some economists now predict, and certainly you could see some diversion of product to the Latin American market so that at the margin our producers would not benefit as much as they might have otherwise benefited because of this arrangement the Japanese have settled on with the Europeans.

That in particular could happen because the debate now between the Europeans and the Japanese over autos has to do with how many automobiles the Japanese can produce in Europe. Now the simple solution for that is you can produce all you want to produce. You just can't sell them here. And there are already, I know, U.S. diplomats who are taking bets that that's the way the current debate will be resolved, that the Japanese auto makers will be told that it's fine, you can produce as many as you want to in your British factories, you just can't sell them here. Find some other market for them. That maintains jobs in Britain, that gives Britain a more positive export balance and it thrusts that problem into the world where our auto makers are already in trouble and they have to face it.

But the trade diversion is not the only problem. By limiting Japanese sales, somewhat, in the European market, there is a poten-

tial for the same problem we created when we limited Japanese sales in this market, it is that you create a premium on Japanese automobiles that are sold in that market. Fred Bergsten's group estimated that at the height of the U.S. restraints on Japanese automobile sales in this country there was about a \$5 billion a year transfer to the Japanese automobile companies in excess profits that they could make out of the U.S. market. The Europeans create excess profits for the Japanese automobile makers by this arrangement. We're all going to suffer because that is just that much more money that the Japanese auto makers can plow back into research and development. And if any of us have any reason to hope that the Japanese onslaught in the automobile sector may be weakening, I only would refer you to the new Camry ads, the new Camry that is coming out this year. It looks an awful lot like the Lexus. I predict it will be a major seller in the U.S. market. Turn to the April 1991 Consumer Reports issue where they go through and analyze the various automobiles; turn to the review of the Lexus and see that Consumer Report says, "this is the best car we have ever reviewed in the history of this publication". Now what that translates into it seems to me is continued trouble for the U.S. automobile industry.

Finally, the deal between the EC and Japan sets an example for the United States. There will be, probably by the middle of next month, new legislation introduced, as some of you are well aware, dealing with the automobile problem. It will be sponsored by Representative Gephardt, Representative Levin, and others who have a deep and abiding interest in the future of the U.S. automobile industry. It will be supported, at least in part, by the auto makers and certainly by the auto unions. The legislation is not complete but conceptually the driving force is the deal the Europeans have struck with the Japanese, the linking in terms of a cap of the exports into the market plus the transplant production in the market, a linking that was not made in the early 1980s when the first United States VRAs (Voluntary Restraint Agreements) were proposed.

But automobiles are not the only issue where we see the increasing trilateral nature of problems. As many of you many remember, last week we had the MITI Minister in town to talk about automobiles and come to some agreement on automobiles with the Commerce Department. Other MITI officials who travelled with the MITI Minister fanned out across the city to talk to various U.S. trade experts or reporters. And one of the lines that they were selling at that time was what was going to happen in the GATT round. They were selling what they consider to be the forthcoming European proposal on agriculture. The forthcoming European proposal as they characterized it would be a down payment of a certain amount of reduction of subsidies for about a 5-year period which would then be rethought in 5 years to become additional commitments to reduction after 5 years, but unspecified. The striking thing about that was, that's the long-standing Japanese proposal on rice. What is interesting is the growing unification of interest between Japan and Europe on the agricultural subsidy issue in the GATT context. And the portrayal of this offer, at least by some lower level Japanese officials who weren't obviously speaking offi-

What would be incorporated the legislation in view of these new trends are three points: One is the free access zone concept. In other words, Japan has now one free access zone, this is in Okinawa, but actually the government is trying if this legislation is passed, to set up at least 5 initial and eventually ten, free access zones in and around the main ports of entry except Tokyo.

A second concept is that infrastructure supporting manufactured goods imports will be improved. In Japan, trade infrastructure as we call it is in fairly a good shape with regard to our export infrastructure. There are lots of spaces for the on and off loading and the quick export to foreign countries. But what we lack so far is infrastructure facility supporting imports manufactured goods. And so certainly more emphasis on the improvements on infrastructure, particularly in the manufactured good imports will be emphasized and stressed.

Third, the legislation would provide special treatment on corporate taxes as well as the land holding tax, and subsidized lower interest loans to be given to the foreign company that wishes to have the facility of construction. This could be rather discriminatory from the standpoint of the indigenous Japanese company, particularly small and medium size companies. But it is a bold attempt to give some discriminatory tax treatment in favor of the incoming foreign company or subsidized interest treatments and facility to the foreign company who wishes to construct factories and so and so. We had a meeting at MITI on the 25th of September, which was the first meeting to have an overall review representing industry as well as government, so certainly this will be the current and major move on the part of MITI to deal with situation as described.

I'd like to discuss and touch briefly on three issues relating to this morning's discussion. The first on the multilateral issue, certainly as the preceding speakers have mentioned, is what leadership role Japan could play in getting the GATT talks back onto track? Always we have a kind of excuse of not talking explicitly, particularly about the Japanese rice issue. Until the next Japanese prime Minister is chosen, I'm afraid action on the rice issue will be deferred. I think there will eventually be some compromise. On bilateral issues, I would like to mention the kind of asymmetry between Japan and the United States with regard to the share of the export and imports. Japan sends approximately 30 percent of its export to the United States and gets 20 percent of its imports from the United States. So we rely more on the U.S. market than the United States relies on the Japanese market, but the United States has more bargaining power.

We do believe that, as I mentioned, in this market access improvement legislation, Japan is very much serious about the bilateral issue. Certainly the one aspect of the issue is that industry is now talking more about the designing-in concept; in other words to invite the foreign component manufacturer particularly an automobile parts supplier, to come to join at an early stage of the research and development so that joint research and development of the components might be carried out. This kind of thing will be more aggressively promoted.

Last, I would like to touch briefly on the regionalism trend. The issue is whether or not Japan can remain outside this regionalism

movement or should try to join in some way. There are three policy options for Japan. One is a kind of the free trade agreement between Japan and the United States. Another is just to stay with GATT. The third, which is the most plausible one, is an Asian Pacific Economic Cooperation (APEC) scenario. Is this APEC scenario Japan should play an especially active role by absorbing increasing quantities of imports particularly from Asian-Pacific trade partners. Japan is becoming more and more an import absorber and that role will be rather critical in the APEC scenario. Certainly in that context Japan in a crude sense would align itself with the trend toward regionalism, but more in the form of the opening of the market for the exports of all the nations, particularly Asian-Pacific countries rather than allying themselves with those who advocate a closed regional bloc. My time is up, and it's certainly a bit disjointed but I tried to brief you on some of the developments as we see them in Japan. Thank you very much.

Discussion

Mr. AHEARN. Thank you very much, Mr. Kobori. I apologize for rushing you through, but I want to give the opportunity to you and your colleagues on the panel to engage each other before we opened it up to questions. Does anyone on the panel have a comment? Jeff Garten.

Mr. GARTEN. I'd just like to respond to what Bob Lawrence said about Germany and Japan. I didn't mean to imply that Germany and Japan had the same kind of system and indeed there are some differences. I think that vis-a-vis the United States, one of the big differences and why we react differently is not just because there is two-way trade but because German penetration of the United States under any measure is not anywhere near as significant as Japanese penetration has been, especially given the timeframe and the telescoping of Japanese investment and Japanese exports in the United States. But having said that, I do think there are three kinds of capitalism. I think that the German kind is different from ours. It doesn't necessarily relate to two-way trade but it relates to, for example, the financial system which is constructed in a totally different way than the U.S. system, a few dominant banks and no stock market to speak of. I think it's different in terms of the way finance and industry relate to one another. German banks have historically driven German industry, owned very substantial parts of big German corporations. You can say it's good or bad, I don't care, but it's certainly not the model we have. When it comes to labor, social benefits, training of workers—no comparison between Germany and ourselves. When it comes to subsidization of heavy industry, historically, you can look at the Airbus case today; the German approach has been different. And when you look at public/private cooperation, today not so much on the national level but on the local level, the interweaving of the universities, the local governments, and industries on a local level, this is a model that again, setting aside whether it's better or worse, is much different than the American model.

And I don't deny that over time people can talk about convergence and at any given time you can look at the debate in saying these guys are changing, it's all going to be different, but I'm just

Mr. LAWRENCE. I think too much emphasis is being placed on Germany as the determinant of European policy. I think if we took agriculture as a case in point, sure, the Germans wanting to be good Europeans are siding with the French. And if we take the whole issue of industrial policy, it is the southern/northern Europe split that is more striking to me at any rate than a German dominated Europe. I see many of the international positions of Germany being much more compatible with the United States than I would, say, see some of the French. And when we're looking out for the future of Europe, I personally think that a German dominated Europe is much easier to live with in numerous policy areas than, for instance, a French dominated Europe. And so I just think it's necessary to put that counterweight to the discussion.

Mr. AHEARN. Bob, I think you have the last word. I just want to thank our panelists for an interesting session, and I think it's going to provide us with the sustenance needed to get us into the next room and have lunch.

Mr. CRONIN. We will reconvene at 1:15. Thank you very much, everybody.

Panel 3—Outlook for United States-Japan Cooperation, and Competition: Future Course of Economic, Political and Security Relations in the Post-Cold War Era

MICHAEL W. CHINWORTH, *the Analytic Sciences Corporation*

KENT M. HARRINGTON, *Central Intelligence Agency*

YUKIO OKAMOTO, *Ministry of Foreign Affairs*

LARRY A. NIKSCH, *Congressional Research Service*

OPENING REMARKS OF RICHARD P. CRONIN, SPECIALIST IN ASIAN AFFAIRS, CONGRESSIONAL RESEARCH SERVICE

Mr. CRONIN. I would like now to turn the proceedings over to Larry Nicksch, who is also in our Foreign Affairs and Defense Division at CRS. Larry is moderator of the third panel, which is going to try to factor together both the changing economic conditions in the world, questions of U.S. domestic competitiveness, etc., with the geopolitical changes at the end of the Cold War and its meaning for the U.S.-Japan relationship. So, Larry—

OPENING REMARKS OF LARRY NIKSCH, SPECIALIST IN ASIAN AFFAIRS, CONGRESSIONAL RESEARCH SERVICE

Mr. NIKSCH. Thanks, Rich. I think we have three very good panelists to discuss our topic for this afternoon. Mike Chinworth, as many of you known, has been an expert on the subject of United States-Japan defense industrial cooperation for many years. He has written widely on the subject; he recently was with the MIT project on United States-Japan defense industrial cooperation, and more recently has come down here to take a position with The Analytic Sciences Corporation over in Rosslyn. I recently worked with Mike on a major study done by the Office of Technology Assessment on this very issue of U.S. defense industrial relations with allied countries, and Mike wrote the section on Japan for that study. Kent Harrington is the National Intelligence Officer for East Asia with the Central Intelligence Agency. Kent has been very active in dealing with a whole spectrum of issues in United States-Japan relations as well as with U.S. relations with a number of the other key countries in East Asia and the Pacific. Besides his many years in government, he also comes from a background in the private sector of research and consulting on these same kinds of issues. And finally we have Yukio Okamoto who is recently retired from the Japanese Foreign Ministry. He was the former director of the First North American Division within the Ministry. The Division has had primary responsibility for relations with the United States. Since his retirement, he has been writing and speaking very widely in Japan on the subject of the future of United States-Japan relations. He has, I understand, a radio talk show and a television talk show; besides his writing he is also consulting for business groups and other private sector groups.

So again I think we have a very good panel to discuss this subject this afternoon. I'm going to ask each of our panelists to speak for approximately 10 minutes and hopefully this will help to get us back on track timewise and still allow a good deal of time for discussion. So without further ado, let me turn things over to Mike Chinworth.

REMARKS OF MICHAEL CHINWORTH, SENIOR ANALYST, ASIAN
TECHNOLOGY, THE ANALYTIC SCIENCES CORPORATION

Mr. CHINWORTH. Actually, I'd rather just follow these two distinguished gentlemen with my comments and say I agree with everything. It would be a lot easier and I probably would say just that. But let me begin for a few minutes and outline a few philosophical issues and then we can talk about things in depth.

We're talking about technology, I believe, I hope, technology cooperation with this new relationship in this new global order. I would like to throw out three basic thoughts and let others agree or disagree or perhaps define the issues a little bit better. Obviously, the world order is changing. What's true for today is no longer true for tomorrow; map makers are pulling their hair out because they have half a dozen new countries every day to consider. The concept a lot of us were raised on, the idea of a Berlin Wall, actually being there forever and the Soviet threat being there forever; being a central part of American policy; they are gone. Everything has been shattered, and we're operating in a new environment. Clearly that new environment affects the United States-Japan relationship.

The premises of American military policy, in particular, directed towards Asia, were heavily involved with its concept of defending Asia against the Soviet threat. Whether or not we all agree there was an objective threat is another issue, but certainly that's the way U.S. policies were directed. Those policies justified a number of subsequent steps that had a number of implications, a number of economic ramifications, that to United States policy makers were fair tradeoffs. The core of that in my mind was technology transfers. We encouraged very generous technology transfer policies towards Japan with the notion of keeping Japan on our side of the ocean politically with the idea of extending our own defense production capabilities, and with the idea of having a foreign basing capability for the United States.

With the Soviet threat disappearing or appearing in a different kind of form, all those assumptions come under question. And I'm sure that people in this morning's sessions would have argued that there were always bad tradeoffs. One way or another, we've got to reanalyze the situation. What was true for the past is probably not valid for the future. Fair enough. Now having said that, what are we dealing with; what kind of threat environment are we dealing with; what kinds of policies should we continue; what kinds of policies should we change.

I'd like to throw out basically three thoughts in that area and then move on to the other speakers. The first is that there is still a legitimate role for the United States in the Asian-Pacific area with Japan as the cornerstone. Our Soviet considerations certainly take on a different perspective these days, but there is a role in the traditional sense that was an element of U.S. policies from day one of the occupation that still remains; namely, being the honest broker in the region. This sounds very—it smacks of white man's burden. It's not intended to be that sort, but like it or not, the United States is the only country in the world that can act as the stabilizing influence in Asia. It's the only country with these insane ideals

that sometimes go awry, but nevertheless, offer some semblance of stability and trust that bind the region together.

One of the major reasons that other Southeast Asian nations would cooperate with Japan for example, is because the United States is there. It stabilizes the region; it makes sure that other countries are not military threats in the traditional sense to one another. I think that role is going to continue for quite a while. That doesn't mean that we necessarily have to have a massive military presence in the region; but certainly we have to keep a focus on how to maintain that traditional role, modifying it according to regional circumstances as appropriate.

The technology transfer policies that were justified by the traditional role, I think, are no longer valid. What might be appropriate for the future, however, is another story entirely, and I'm not sure if I have any clear views or even opinions on that one. What does come to the front, though, is the second thought that clearly the role of Japanese technology in this relationship is assuming more importance. Clearly the United States has recognized that there are economic implications to our technology transfer policies that we don't think are necessarily appropriate anymore given Japan's obvious status as an economic competitor with the United States. And I say economic competitor in a neutral sense and not good guys and bad guys. It's a fact of life that Japan and the United States are economic competitors. Ultimately that should work towards the good but we'll get to that later.

Now having said that Japan's technology is more important and having said that we don't necessarily want to encourage unilateral flows from the United States, then what do we want from Japan? And I would say that obviously we're looking to Japan as a source of technology inputs into the United States, both for traditional security reasons but also for these economic reasons.

I'd like to throw out the thought that others can discount or treat accordingly, that Japan should consider in the future the same kinds of tradeoffs that the United States accepted from 1950 up until a few months ago, at any rate; namely that there are risks involved in transferring technology to a competitor but in the name of a political relationship that has numerous associated values and benefits that those risks are taken. For Japan that will probably be a very, very difficult concept to accept because, my view, the strength of the technology base is equated with the ability to grow economically, and Japan is a country where business and government both agree that the ability to grow economically is equated to the ability to survive in this hostile world that Japan faces. So it's going to be very difficult to sell the idea that it's not only in the economic interests of Japan to transfer technology back to the United States, but in a lot of vague, nebulous political ways, it's a very good and enlightened self-interest policy to pursue in the future.

The third point that I'd like to throw out and then I can wrap up in 5 minutes is that while we are encouraging this reevaluation of our own role in Asia and while we're encouraging Japan to look at a new role of being a provider of technology to the United States instead of just an adapter of technology and an absorber of technology, the third point is that the United States really must define its

expectations of itself vis-a-vis Japan and its expectations of Japan vis-a-vis the United States.

One of the characteristics of the United States-Japan relationship today is total confusion. We have a number of inherent contradictions in this relationship that seem to be the result of conflicting desires, conflicting expectations, conflicting ambitions, primarily on the United States side. We want Japanese technology but we don't want dependency on Japanese technology. We want Japanese investment, but we don't want Japanese factories in the United States with Japanese flags out front and the market penetration that comes with that. We want Japanese capital flows to the world but we don't want strong Japanese influence in the financial markets globally. So on and so forth. We want to have a codevelopment project but we don't want to sacrifice our technology in return for a highly risky strategy of getting Japanese technology in return.

Well, you can't have it all ways. You've got to give; you've got to take. We have to define what's acceptable to the United States for the next 20 years, just as policy makers in the 40s, 50s, and 60s defined those tradeoffs earlier. However those policies played out, there were conscious tradeoffs made and they were pursued for decades, and that did enable a stable relationship between the two countries. I think that's central to the relationship of the next several decades, identifying those tradeoffs, accepting them, articulating them, and then pursuing policies accordingly. So at that, thank you.

Mr. NIKSCH. Thank you very much, Mike. Kent.

REMARKS OF KENT HARRINGTON, NATIONAL INTELLIGENCE OFFICER
FOR EAST ASIA, CIA

Mr. HARRINGTON. I'm going to have to make the same disclaimer that Bill Brooks made this morning that the views I'm about to represent are my own, not those of my employer. Actually, if I gave you my employer's views on the subjects at hand, I could easily keep what I have to say within 10 minutes in the form of no comments. So, I can at least earn my lunch by speaking my own mind. When I was offered the opportunity to speak at this group, I naturally was both flattered and eager to be here to participate. I think in his introductory remarks, Jeff Garten let the cat out of the bag since my real assignment of coming here is to collect the tapes of his remarks and bring them back to our headquarters. Let me try to fill in the extra time that I've got to discuss where cooperation and competition may be going in the United States-Japan relationship the next several years.

I'd like to put forth three propositions and discuss their implications. The propositions are pretty straightforward. The first is that the demise of the Soviet Union as an integrated whole and as a consequence the demise of the Soviet threat as we've grown to know it in the postwar period brings much more profound changes to the United States-Japan relationship than simply in the defense or policy realm. And I say that because in reflecting on what our defense cooperation has meant, the process of putting together a relationship that I think, as a personal view, has functioned ex-

traordinarily well, especially over the last 10 to 15 years, in creating both the substance as well as the potential future form if needed of real security cooperation.

This process has involved a series of acts, if you will, on the side of the Japanese government as well as the U.S. government that have essentially carved out a rationale for security cooperation and more generally for more political cooperation between us as allies that is really at issue today. Not at issue in the sense of being an open question to those who believe United States-Japanese cooperation in East Asia and more broadly on the world scene is a valuable and indeed a mandatory thing to serve U.S. interests as well as Tokyo's interest, but at issue in terms of what will succeed the Soviet threat as a politically acceptable rationale in Japan for the kind of intimate cooperation that we enjoy both in the military and in a political sense around the world.

What do I mean by that? I mean that if you look back over the period really dating from the 50s, the Soviet Union provided, I would argue, a uniquely appropriate and fortuitous focus for the United States and Japan to develop the connection that we did develop in the security policy area. It's pretty obvious that the Russian-Soviet threat has been around as a concern of Japanese policy makers imperial and postwar for a long time. It's also pretty obvious that the nature of popular attitudes towards the Soviet Union easily underpinned political strategy on the part of the Japanese leadership that was able to focus attention and develop a rationale for cooperation with the United States, that won reasonably broad acceptance over time among Japanese voters as well as among politicians. And finally, it's also quite clear the Soviets did us a good deal of favor by virtue of the way they managed and implemented policy towards Japan. What reinforced that, I would argue, was Japanese proclivity to see a real as well as perceived Soviet threat as something that required a response on Japan's part in firming up and elaborating its alliance with the United States.

All of these things have led to a policy in the defense area, and I think arguably in the broader global partnership as it has been styled until recently that found a good deal of acceptance because these terms for the relationship were both well understood and well ensconced in the Japanese popular mind as well as in the Japanese political world. With the Soviet Union gone and the way I just described it, with Japanese attitudes likely to change, indeed inevitably changing towards the Soviet Union, I think there is an opening if you will for differences of perspective on basic security interests, and differences of perspective on how we manage those interests. A number of speakers earlier this morning I think laid out very clearly how you might be more specific about pointing out where those specific differences might arise ranging from intervention in other countries' affairs to the extent which we cooperate and divide up the labor; pocket book diplomacy versus military power applied to problems at hand. But the point I would make is quite simply that however you characterize where our differences or our areas of agreement may lie, the demise of the Soviet Union as a focus for that collaboration within and outside East Asia raises a great many basic questions about what the real intent of United States-Japanese collaboration will be in the future on the

part of those especially inclined to be skeptical about its value overall.

The second point I would make is that from the American point of view in East Asia, there are real threats and potential sources of instability in East Asia that to us represent, I would argue, a reason for sustained United States-Japanese collaboration. However, many of these threats and potential sources of instability are also highly controversial in Japan. And I need only mention the situation on the Korean Peninsula and the future of China as an entity in this post-Cold War, postcommunist system world to cite two that would require a good deal of spade work on both our parts, that is the United States and Japan, to develop the kind of basic understanding about where our interests indeed coincide and where they may differ if problems arise in either place that will require some sort of joint response on our part.

In the Korean case, I think, the issues are pressing today whether one looks at the North Korean nuclear question which clearly the Japanese government has made an important aspect of its dealings on normalization with Pyongyang, or one looks at the sustained buildup in North Korean military capabilities.

Whatever one thinks of North Korean intentions, we're talking about an area that is both close to Japan in terms of its core security interests, but highly difficult for the Japanese government to deal with in the way that it will, I think, need to deal with, if it's going to put forward a politically acceptable rationale for sustaining cooperation with the United States. In dealing with potential instability in Korea the Japanese Government also must consider what rationale will play in Washington that will be received here in a way that doesn't raise in the future questions about what role the U.S. role is playing, and why, in defense of Japan at some future point, and therefore call into question this aspect of United States-Japan cooperation. In other words, the Japanese and we will have to think together about how we can harmonize what we say in each capital about what arguably is one of the principal potential threats to stability and security in the area and that is untoward developments on the Korean Peninsula in order to both prepare for them in a practical sense but also to rationalize them in ways that are acceptable in both countries.

The China issue is a little more difficult to easily characterize, but I would simply say that perhaps more than us Japan has already recognized the potential impact on its own shores of instability in China. Tokyo has attempted to refashion its relationship with Beijing, at times moving at a pace different from ours; at times moving in step with the United States. One can only speculate about the future but in light of the fact that China's response to events of June 1989 has by no means done away with Beijing's problems, in terms of threats to stability in China, and in light of the fact that the geriatric leadership now in charge in Beijing is slowly but steadily going to go away, this issue of how we and the Japanese deal with the potential for change in China and the prospects for instability is going to remain a centerpiece for the better part of the 90s, whether things happen tomorrow or whether they happen 10 years from now. It's a core security concern for both of us in the region.

The third point I would make is that many of the issues that we are going to be compelled to collaborate on in the years ahead are already with us and they are, as other speakers have already made clear, extraordinarily complex. Look at the proliferation issue by itself and ask yourself the question, is the U.S. government structured in a way to deal effectively with nonproliferation policy. I think the answer, arguably, whether you look within departments or among in between agencies, is no. That is very difficult for us because of the complexity of this issue to deal with its technological as well as military security dimensions in the way our current government is set up.

I would argue the same thing is true, perhaps true in spades, in Japan. And if we and the Japanese are going to be able to cooperate effectively in this area, for example if we are going to be going to Tokyo, as I suspect we will to seek from Prime Minister Kaifu or a successor if that turns out to be the case, actions that follow on the commitment that Tokyo recently made to make proliferation policy considerations part of its decision making on aid relations with countries that are potential proliferators, both we and the Japanese are going to have to be able to deal organizationally in an effective way with this issue. We're going to have to be able to put together some sort of decision making structure, speaking let's say on the Japanese side, that brings together the interests and equities of MITI, the Foreign Ministry, the Defense Agency—organizations which are inherently competitive as all bureaucracies are, perhaps extremely competitive in the Japanese context; they are competitive here too, their counterparts are I should say; but ones whose cooperation is vitally important if this kind of policy is going to be implemented effectively.

If we're going to bring to bear let's say sanctions against potential proliferators in the future that are real and effective, we're going to have to be able to communicate and to make policy work. I'm not sure the structures either of us have at the present time in our respective capitals are going to be able to do that, at least do it very easily. Now there is some good news in East Asia, I would argue, and that is that we are all compelled to ask the proverbial \$64 question about the remaining recidivist regimes—China, the North Koreans, and the Vietnamese, and that is when will the change come that's happened in Eastern Europe and the Soviet Union? I think most people would agree that in East Asia, while change may be in the offing, it's probably going to come slower and in different forms than we've seen it come elsewhere, and that gives us time as allies to work out some of the issues and some of the problems that may be attached to those issues and how we deal with either instability or threats to security in the region.

The point I would make, however, is that in doing so we need to think about these problems on two levels. On the practical level that I last mentioned, and that is the mechanics of policy making and implementation, that's quite essentially the bureaucrats job. I'm sure there are plenty of people that are paid around town, at least in this city, who will get busy and do that over the next several years. But we also need to think about it in a political level because as I mentioned at the outset, the changes in the Soviet Union and in the communist world generally have called into question,

from my point of view, the fundamentals of our security cooperation as popularly presented over the last 30 to 40 years. And for that reason it's going to take, I think, an act of political leadership on both sides to raise up to the level of commonly understood rationale why we are continuing to cooperate in this area. I happen to think it's a salable case to be made, but I'm not necessarily certain that the issue has the priority in either capital today to be articulated in the way it needs to be. So I would simply leave you with that final point that we're dealing with a problem that I think needs to be addressed both by the gremlins that run the machinery as well as by the leadership at the top that will define the direction in which the machinery ultimately runs. Thanks.

REMARKS OF YUKIO OKAMOTO, FORMER DIRECTOR, NORTH AMERICA
DIVISION, MINISTRY OF FOREIGN AFFAIRS

Mr. OKAMOTO. Hello, I'm a free man and thank God I don't have to make the same kind of statement Bill and Kent had to make. They have to join my club soon. Yesterday evening, I received 26 faxed pages from my secretary which was a minute of the speech I made in a Society in Tokyo, and I cunningly thought "good I don't have to prepare for the speech for tomorrow, I'll just use a few lines from my own text." This morning, to my utter horror, I found out that I can't use any lines in this speech I made in Tokyo. Why? Because I will have to be addressing two very different audiences of differing perceptions. The gulf between the two perceptions is wide. In Japan, I'll have to be constantly saying that it is more incumbent upon Japan to change and although the United States has certain points they should improve, Japan should really change its social structure, educational system, political and administrative system, and so forth. But in the United States, I have to be constantly warning you that your perception is wrong and the notion that Japan cannot fundamentally change in any way is wrong. This fact alone besides making me schizophrenic, is a symptom of deep serious problem at the psychological front despite the fact that we are going along quite strong in terms of substance. So I'm just using my left brain today to say the United States is wrong whereas in Japan I'll be using my right brain to say Japan is wrong. There is certain bad news between the two countries and the most serious thing is that I think the level of negative perception in this country has grown beyond the level of past years. Everything Japan does or doesn't do is a target of criticism; we're in a sort of damned if we do or damned if we don't situation. What worries me is the same kind of tendency has begun to take place in Japan as well.

I give lectures almost once every 2 days to groups ranging from 20 to over 1,000. Most of them are business people because as Mr. Brooks said, business people are actually your eyes and they are very much concerned as to what will happen to the United States-Japan relationship. And so naturally they invite me to talk. And the tune I used to play was, as I said, certainly United States must change, but we have to change more. This line used to be accepted with good reception until 2 months ago or so, but these days I'm increasingly facing a hostile crowd saying that "you're too soft, you

are too pro-American, why do we have to be treated so badly by the United States?"

The mounting frustration has two reasons I think. One is that they are exposed to headlines in Japanese newspapers every day, Japanese TV screens portraying Mrs. Helen Bentley and others in the American Congress, perhaps blown out of proportion but Japanese newspapers go to these people who emotionally attack Japan and they convey it with fanfare to Japanese public. And we resent that, and we have childish arguments like Mr. Ishihara does saying that the United States can't survive without Japanese technology, which doesn't mean anything logically. And then you react to that. We are sort of in a vicious spiral, whereas I still think the central core of the public mind towards each other has a warm reservoir of good feelings towards each other.

The second reason is that the Gulf War has done more damage perhaps than any other incident within the last several decades to our psychological relationship. Your continued use of term of coalition partners and others meaning that there are 28 countries who sent troops there treated like first class citizens, and others meaning second class citizens who didn't send their troops there. Now the Japanese are saying that, wait a minute, that's not the way we should be treated. And of course they are aware of public opinion polls conducted here saying that Japan's contribution belongs to the lowest, along with Iranians and Palestinians, or that 70 percent of American people think that Japan is now a new enemy instead of the Soviet Union. And they are saying, "hey wait a minute, we didn't send our troops that's right, but what about the financial contribution we made?" Four hundred dollars per average household was contributed to the Gulf War, not through windfall price rises of oil but through tax rates. They are now beginning to realize that they too have contributed at the sacrifice of their own personal welfare.

What I want to stress is that 70 percent of Japanese support such a tax increase, but at the same time they are saying that we are contributing as well and Americans are saying that Japan will be the 29th country, at best, after 28 coalition partners, because we didn't send troops. It's certainly unfair to have this kind of demarcation line. That is being translated into mounting frustrations among Japanese people.

Of course there is good news as well. I think we have been continuously witnessing an amazing amount of resilience that exists between the two countries. We talk about trade problems all the time, but let's follow our past record starting from textile to machine tools to color TV to automobiles, steel specialties, steel, farm products, you name it. There is no single issue that came to the negotiating table and not solved. Rice, we are currently discussing it in the multilateral forum, but we have proven to be so capable in solving every crisis and issues that came between us. Have we exhausted issues? Of course not. Because of the gigantic size of the two economies, we will continue to have these issues but I remind you that these are issues, not problems.

Of course some people don't agree that this phenomena is going to bring a fundamental change to Japan. Clyde Prestowitz says that this is the same story you have been hearing for the last 10

years or so, but I don't think so. The momentum and the scale of the change that is undertaking in Japan is quite phenomenal and public perceptions are changing that will accompany institutional change within a few years time.

I for one am rather afraid that the swing of the intellectual pendulum in the people's mind may be going too fast. Only 30 percent of Japanese people supported the dispatch of mine sweepers last October; half a year later it's up to an amazing 70 percent. And the fact that this quick change in public perception is taking place without deliberate discussions and articulate cautiousness, about what Japan should be doing, is not an issue so far. But the bottom line message is that we are changing.

The other good news is that we continue to have a very solid interdependence between us. Interdependence is not a dirty word. The degree of relationship between the two countries is taking place at a level undreamt of. For instance, Japanese companies in the United States employ 100,000 people which is not very much, only 0.4 percent of your total work force, but they account for amazing 7.6 percent of your total exports to the world. Japanese are now coming in and with Japanese companies becoming more and more national in character, they will be a good catalyst to strengthen the economy of this country. Within the larger picture of integrated market of the Pacific Basin, I think Japan can play a very useful role.

Security wise, of course, we are indispensable to each other. Your forces in Japan are primarily for our security of course, but if you look at the composition of your forces you cannot live without them without endangering your own security in the Pacific. Out of 50,000 forces you maintain there, only 2,000 Army troops are for the exclusive defense of Japan. The rest are all for regional defense purposes, not to mention about the large U.S. fleet that looks after the entire West Pacific and Indian Oceans.

Several more points worth mentioning. The United States must change in many respects, I think. In view of the shortness of time, I won't go into it, but I think you sometimes have an excessively long institutional memory. Once you have reached a quick judgment and have a stereotype image about any country or people, you tend to stick to it too much.

Your policy fluctuates too much, maybe. Fine. Tiananmen Square was an inexcusable incident; attacking China on the human rights aspect was the right thing; but at the same time you are hailing some states in the Middle East who are almost like medieval in terms of human rights as some your best allies. And these inconsistencies are seen increasingly by the Japanese public as the United States being too self justified from time to time.

Nonetheless, as I have been telling Japanese audience, I think it is incumbent more upon Japan to change. Our leadership is weak, not because of any particular personality, but because for institutional reasons. I can go on and on why Japanese political leadership is weak institutionally, but I'll forgo that. It will suffice to tell you that Japanese path of policy has been like a curve, because the most important motion is the consistency. Consistency from yesterday to today, from today to tomorrow, is the most important thing. So if you take as it were differential calculus approach, you will

find no mistake in the path of Japanese policy making. But if you take integral calculus approach, you will see that the path of Japanese policies are deviating quite substantially from the line where Japan should follow.

It takes a political decision to cut this curve and change the course of the nation, such as when Mr. Nakasone privatized The Japan National Railway. The red-ink ridden company now becoming one of the most lucrative private companies. Or Mr. Takeshita resorting to the introduction of consumption tax. Unfortunately, when such a courageous decision was needed in terms of security, the present Administration was unable to do that. Bureaucracy is very resistant to change because of the convoy type decision making process where the speed of the entire convoy is adjusted to the slowest sailing vessel. So in times of peace, it is a very nice way to keep our society together but in terms of contingencies, we cannot move fast. I will end my remarks by saying that what kind of world this Post-Cold War era will be remains to be seen, but there will be a lot of room for more cooperation between the United States and Japan in the Pacific. The Russian Republic is going to be a more eastward looking country than the combined Soviet Union, with intervening states existing on the European border but facing directly east. Korea will be reunified within 10 years perhaps, but let's face it, we are not sure if we are going to have a friendly nation in the Korean Peninsula. In Japan, there will be a sentiment among the public mind to be friends with the Russian Republic which will complement our efforts to maintain the stability of the Korean peninsula. In the final analysis, the U.S. defense security system will remain the most reliable and perhaps the only source of stability in the Pacific area. Thank you.

Discussion

Mr. NIKSCH. Thank you, Mr. Okamoto. Let me ask you to please identify yourself when you ask your questions or make any comments. We have still twenty minutes for questions and discussions. Who would like to lead off?

Mr. ED RENNIC, General Motors in Tokyo. Mr. Okamoto, I wonder if you would care to comment or give your view on who you think the next Prime Minister of Japan would be?

Mr. OKAMOTO. I don't know. The political analysts are almost in a unanimous view that Mr. Kaifu will get reelected at least for a year with one year's extension. Because not everybody is satisfied with Mr. Kaifu, who has been characterized very interestingly by a Japanese phrase which literally means the affable, weak chap next door whom you want to help. So that means he has not many enemies and when there are no strong runners, the natural course is that he will get reelected.

Mr. JIM DELANEY, National Defense University. I find it interesting that we've had high quality discussions here now since 9:00, and this is the first reference to politics of either country. I think it shows how little both sides have come to expect on these major issues from politicians. I don't want to sound too cynical and say does it make any difference who would be the next Prime Minister of Japan, because I think some of the earlier speakers and you folks too have indicated the kinds of issues and decisions that in-

creasingly will be resolved by people outside the political spectrum as such. But I want to ask this panel if, assuming that the security relationship will survive and that a new rationale can be developed, is there some way that those who manage the security relationship here in Washington and in Tokyo, can expand the relationship, develop the kind of value system that is needed to limit the amount of chaos that is going to creep in if we leave the future of the relationship to lawyers, trade negotiators, politicians, and others? Given these market forces at work, a reduction of the Soviet threat and so forth, is there something that the security people on both sides can introduce into this in terms of a value system that will minimize problems in other areas of the relationship and point towards cooperation, for example, in technology?

I see us on a potential collision course if, as a country whose military capabilities become increasingly dependent on high technology on the one hand, and you have our number one partner in the world, or certainly in Asia, without trying to disadvantage us, has a policy of gaining dominance in many of these key technologies? When are we going to sit down as security people on both sides, rather than leaving this to the trade negotiators or the technologies themselves, and work out how the direction and the course of this? Isn't it about time that the security people stepped up to the line on some of these economic, technology, and other issues that have security implications?

Mr. NIKSCH. Who would like to address that?

Mr. CHINWORTH. I'll sacrifice myself. I would argue that the security people need to reestablish the realization that there is no distinction between security, economics, politics and all the rest. It's all interrelated. You can't say on the one hand that the United States should remain in Asia in order to encourage stability because it brings about economic growth and development, and then stop there and deny the fact that that leads to competition. It's impossible.

Mr. HARRINGTON. I think I would say two things. First I think political leadership does matter when it comes to this aspect of a relationship and the message that I carried away from this morning's discussion was principally that insofar as the real forces driving economic, technological, and related ties between the United States and Japan, the government's role has increasingly become marginal as both economies have diversified abroad and the nature of the issues has been more and more private rather than public-sector determined. But that analysis I don't think applies to either political or security policy relations between the two countries. And I would argue that much as Mr. Okamoto said, there are good grounds for optimism that security cooperation between the two sides will persist in the 90s.

There still is an open question as to who in each country will articulate why that relationship is important and in terms that both protects and preserves it. I don't take issue myself with the necessity for the United States-Japan alliance, and I find it difficult to explain in practical as well as political terms why it is so important. It seems to self-evident to me that it's strategically important to the United States to have the tie. But to be able to articulate that in a way that appeals to as broad a spectrum as did the previous

rationale in both countries is still a job that's undone. That fact is evident in light of the frictions that have arisen over things like FSX, which is quintessentially the kind of cooperative project that seeks to bring together both sides of this equation that, as Michael points out are something we should be thinking about as an integrated whole. Someone has to find a way to lay a foundation for an integration of the two sides of this equation, not necessarily for that (FSX) kind of project or that kind of program that may not be what we want to do in the future in terms of industrial and defense cooperation, but for future collaborations combining the economic/technological with the political/security factors.

Mr. OKAMOTO. I have nothing to add.

Question. I'd like Mike Chinworth to follow up on that. You said earlier in your talk that the United States was serving as an honest broker trying to play a stabilizing role in East Asia. Then you said that clearly that kind of activity or role would lead to an increase in economic competition down the road. How do you sell that to the American people as a new rationale, a new justification for our involvement in East Asia?

Mr. CHINWORTH. I may be naive, but I think it's an easy sell. The economic growth of the region to date demonstrates that this is a group of booming economies that the United States should be able to prosper along with. Maintaining the stability that makes that economic interaction possible is a U.S. role. So to me, it's an easy sell. In these days of declining budgets and pressures to reduce the military across the board the expense associated with remaining in Asia is a little harder to explain and a little harder to justify—

Question. Are you saying that in a world where there is no Cold War, the Soviet Union is not a menacing role, it would be an easy sell to persuade the public that we're required to intervene in some areas of Asia to maintain stability?

Mr. CHINWORTH. Everything that leads up to that is an easy sell. Obviously maintaining forces in a region and the credibility of all the positive benefits result from it. You know the stabilizing presence, the whole idea of presence equates with stability, depends on the willingness of the United States to actually use force. So the getting to that stage and actually justifying the intervention is obviously something very, very difficult to do. However, everything leading up to that is in my mind an easy sell because the alternative is instability; the alternative is Japanese rearmament, the potential for which is enough to stimulate rearmament drives by any number of countries and so on and so forth. The actual use of military force in Asia obviously is a last resort; if everything else is working in front of that. If our political mechanisms are working, if our economic mechanisms are working, then we shouldn't have to resort to that, but obviously in order for that military presence to do its job, it has to be credible, and to be credible, you have to be willing to use it.

Mr. OKAMOTO. Well I have to point out that despite your budget cuts, it makes economic sense to maintain your forces in Japan because you cannot keep your forces anywhere more inexpensive than in Japan. Its more expensive even to keep them in the continental United States because of the Japanese host nation support, but more importantly, Asia will continue to be a region of political

instability. And for many Asian countries, they have varying degrees of threats; the threat structure is very complex; for some countries, the Soviet Union will continue to be a threat; for some countries, China, North Korea, or unified Korea, or Vietnam. We talk to Asian friends very often and with the exception, I must admit, of Korea and China, the rest of the Asian countries really look to United States-Japan security system, the core of which is your stationing of troops in Japan as the sole source of stability. And your role in that regard will not change.

Mr. LOUIS COHEN, Independent Consultant. I was interested to hear and also disturbed to hear the impressions that you are forming, Mr. Okamoto, that in Tokyo as a result of discussions with businessmen and their perceptions of the United States. I think there are strong echoes here as well; the origins are essentially the same. I think the Gulf War tremendously damaging the perception of this country that the role Japan played and how it was played. And I think more recently the financial scandals centering around the Nomura and the securities houses punctured a bit of a myth that had grown up in this country to the effect that in Japan the game was played relatively fairly by everybody. And if the Japanese are not playing fair on their own turf, how anyone remove the impression that they are not playing fair in this country in terms of their business. I think that's an impression that seems to be taking root on the Hill, and I think it's something that's added to the perceptions and the almost instinctive reflex action in terms of anything Japanese, this negative feeling that seems to be induced. I, for one, feel that that's a dangerous trend and ought to be taken into account.

Particularly over the next couple of months in preparation for the President's visit to Japan towards the end of November, he will be in a very interesting situation in terms of influencing the direction of the United States-Japan relationship for the next couple of years. And at this important crossroads, I wonder whether Mr. Okamoto or any other members of the panel would want to comment about what sort of approach both the President and the Japanese Prime Minister might adopt in terms of one, trying to do something to arrest this trend of deteriorating perceptions, and two, set the stage for a continuing collaborative approach in the security field.

Mr. OKAMOTO. I think the answer is quite easy. Just as Americans are, Japanese are the people who loved to be loved, and the important message your President should tell the Japanese public is that we don't hate you. Because that is the message needed to offset this continuous flow of inflammatory rhetoric coming from the United States as I told you. And although I cautioned against the deteriorating Japanese sentiment, at this stage, I will say it's still skin deep. By every consensus taken, Americans are the most preferred people by Japanese people by far. And I think that sound national sentiment towards the United States is still there.

Mr. STUART FELDMAN, Office of Senator Hatch. I have a question for Mr. Okamoto and Mr. Harrington. I was wondering, I think one of the problems following the Persian Gulf crisis or at least the perception of the United States was that Japan didn't respond in a very timely fashion, but whether that's true or not is debatable.

But I think that people in the Japanese government will admit there is not a very effective crisis management infrastructure as far as coordinating policy during tense time constraints. And I was wondering if there had been any changes in the institutional approach to dealing with crises as a result of the Persian Gulf crisis.

MR. NIKSCH. Who would like to answer that? Mr. Okamoto.

MR. OKAMOTO. In retrospect, there were a lot of things we should have done differently. I'm not saying that what the Japanese government did is flawless. No, there were a lot of things we could have done more, but what I wanted to tell you was that when you attack or launch a tirade against Japan you weaken your legitimate claims.

The Japanese were very slow to move to decision, as I told you about this political "convoy." And with what I regret to say was the absence of strong leadership when it was most needed, and there was not an integrated policy decision making center. Yet, so many heart moving stories are hidden behind a simple notion that Japan was a nondoer. For instance, nobody knows about Japanese engineers being in the desert; they came back to me with gleaming eyes holding letters from your base commanders saying that how devoted you are in making our soldiers able to drink for the first time drinking water from desalination plants. These are the engineers who went to the desert during the war time to install desalination plants. I can read to you lots and lots of human elements we put into, but we were so lousy in making our efforts known to the American public. And it was very unfortunate.

MR. NIKSCH. Do you think this was, this inability to convey your message on the Gulf, was this a failure of political leadership at the top? Did Prime Minister Kaifu in particular fail, or is the failure deeper than that? I've always thought that Prime Minister Nakasone might have ended up having to do the same thing last year but would have done it in such a different way that the perception over here would have been decidedly different than it was.

MR. OKAMOTO. One mistake we made was to assume that we have a lot of advocates in the American government who would make a case on behalf of Japan. We thought, so as long as we let people in the government positions know what we are doing, then we will be all right. But of course we underestimated the very strong resentment of the Congress, in front of which any American administration, or for that matter, any individual, or will be reluctant to communicate Japanese efforts. That's number one. Number two, inflexible. The Japanese bureaucratic system failed to produce a quick reply. For instance, Japan came up with a \$4 billion contribution in September, only 2 days after the American Congress passed a resolution to withdraw American forces from Japan, and everybody in the Congress said that Sea of Japan is the country most vulnerable to the American pressure, and that's the only way you can make Japan move. But anybody knows that in a civilized budget system you can't produce \$4 billion within 2 days. That was an unfortunate coincidence of actions. But we could have done it sooner.

MR. NIKSCH. We have one more question. I think there was a question.

Mr. ED GRIFFIN, George Washington University. Actually the gentleman from Senator Hatch stole it away, I find myself wondering whether the apparent bad crisis management and the appearance of a grudging response might have a lot to do with the low level of U.S. appreciation.

Mr. NIKSCH. We have time for one more question.

Question. I'd like to follow up on what we're discussing because what I'm hearing is that the mutual resentment we had in the United States and in Japan after the Gulf War crisis was done was just a matter of PR. If we'd done better PR, this problem wouldn't arise. I don't think that's true because as long as you have an asymmetry in contributions in any intervention, I think that you're going to have the types of problems that we just saw. And therefore, until Japan is able to be a full partner in interventions like we had in the Gulf War, we're going to have situations like we now have. The question of course is does Japan want to be a full partner in such interventions or does anybody else want Japan to assume that role? My point is that I don't see it as merely a PR problem.

Mr. NIKSCH. Does anyone want to comment on that one?

Mr. OKAMOTO. PR is only one element I was referring to. Other elements were the sluggish movement of Japanese government and your stereotype image of the Japanese people. I'm simply saying that your frustration exceeds, is far in excess of legitimate reasons. I think your criticism towards Japan is disproportionate.

Mr. NIKSCH. Well, it is 2:30, we have gotten our panel back on time despite the late start. I would like to thank all of our panelists for what I think were some very stimulating remarks, and would like to thank you for coming and for your very good questions. We will immediately switch to the final panel of the conference and move on. So thank you very much again.

Panel 4—Plenary Session: Policy Implications and Recommendations

MICHAEL NACHT, *University of Maryland*

KEVIN KEARNS, *Economic Strategy Institute*

RICHARD P. CRONIN, *Congressional Research Service*

OPENING REMARKS OF RICHARD P. CRONIN, SPECIALIST IN ASIAN AFFAIRS, CONGRESSIONAL RESEARCH SERVICE

Mr. CRONIN. We have a challenging assignment for our panelists in the final session. That is to survey the ground that we've covered today, or at least look back on the terrain we've covered, in a way that brings us back to some kind of integrated way of looking at United States-Japan relations. As I mentioned at the outset, one of the reasons for restructuring panels three and four was a feeling that particularly in light of the developments in the Soviet Union and the even more rapid unraveling of the Cold War than had been expected, we really needed to try to get a more holistic or synergistic view of how all the aspects of the relationship fit together in the light particularly of these political developments. In terms of moving towards a discussion of the policy implications and recommendations for the United States. I thought it would be really helpful to start out with two discussion leaders who would put in somewhat bold relief, hopefully, two kinds of competing views of what the U.S. stake is in the relationship and how it should be pursued.

To do this, I'm pleased to have two very able and experienced speakers. Michael Nacht, to my left, is Dean of the School Public Affairs at the University of Maryland, and before that he was, for 9 years, at the Harvard Program on United States-Japan relations, part of that time as Acting Director. He's written an article with I.M. Dessler which particularly caught my attention when I was putting this program together. Its called "Beyond Mutual Recrimination" and was published last Winter, in *International Security*. Michael Nacht has also testified recently before the House Subcommittee on Asian and Pacific Affairs on the issue of the future of United States-Japan relations. That testimony came very closely on the heels of the revelation of the so-called Japan 2000 report which was leaked to the press after a conference which had been put together at the University of Rochester under CIA auspices and created a lot of controversy, as we know.

The other panelist, Kevin Kearns, is a fellow of with the Economic Strategy Institute. Kevin also caught my eye in particular because he had written an article about 2 years ago now, calling for a "Team B" approach to the issue of United States-Japan relations. The idea was a follow up to earlier approaches, efforts that had been made in the Reagan administration to look at the Soviet relationship from a Team B perspective, to bring to bear an alternative view of how to interpret what was going on in the Soviet Union, Soviet military programs, etc. Kevin raised this issue, particularly in connection with the FSX debate and its implications for U.S. technology and U.S. security interests. Prior to going to the Economic Strategy Institute, Kevin was in the Foreign Service for a number of years, and had a number of Asian assignments including Seoul, the Philippines, Tokyo, and also in Germany, which

is very relevant to what we're talking about today and which keeps it in perspective. He's also been on the staff of the Senate Foreign Relations Committee in the past. So without more introduction, I'd first like to let Michael Nacht have a try at giving us one alternative way of approaching this problem. Thank you.

REMARKS OF MICHAEL NACHT, DEAN, SCHOOL OF PUBLIC AFFAIRS,
UNIVERSITY OF MARYLAND

Mr. NACHT. I'm not quite sure that Kevin and I will completely satisfy Richard's objectives here, but I'll give it a try and maybe if I'm not fully compliant, Kevin will more than comply. What I'd like to do is first summarize briefly four points of what I heard today. I think that's part of my role. And then I'd like to put it in a bit of a broader context as I see it in terms of the changing American mood in light of the collapse of the Soviet threat and then talk about some concrete paths in United States-Japan relations.

It's hard obviously to summarize; it was a very rigorous discussion, many very interesting presentations over the course of about 6 hours, so I'm not doing justice to all the complexities. But if I had to summarize, and I now to have to summarize, I would offer the following four points.

The first point is that the economic relationship between the United States and Japan is becoming even more, rather than less, complex, but that on balance what still is happening is that Japanese economic power is rising, not only in absolute terms, but relative to American economic power. And it is not only rising relative to American economic power, but it is seen by some as challenging the United States for world economic leadership. And it is this challenge that disturbs many Americans. It doesn't disturb all Americans, and it's even disputed by some Americans that it is a fundamental challenge, but that would be sort of the first point. And in that sense, although there have been many adjustments and improvements on the bilateral economic front, that challenge remains unabated and is a source of serious concern in the United States.

Second, the American concern about this challenge does ebb and flow and maybe at the moment it is ebbing. But it could flow again tomorrow. The ebbing and flowing is a function of many matters, some of which don't have much to do with United States-Japan relations. They may just have to do with the general health of the American economy or buoyancy after a victorious military effort or something. They also maybe ebbing at the moment because in terms of one major quantitative indicator, the bilateral trade relationship, the numbers are more favorable or less unfavorable to the United States than they used to be. So at the moment the American concern is ebbing, but it can turn around and flow tomorrow.

We didn't hear a lot about Japanese views on this but from what I heard Mr. Okamoto or Mr. Kobori say, and from my own general sense of what's happening in Japan, I'd say we still are seeing a cross current of opinion in Japan, but I would have to say that the general trend in Japanese views toward the United States-Japan economic relationship is one of growing irritation and growing resentment.

The final point I would make from what I heard today is that if one had to characterize the United States-Japan bilateral relationship, and this is not a set of terms that were invoked in the discussion today but I'll try to use them, I hear what people said today as basically examining a balance of centripetal forces keeping the alliance together, and centrifugal forces pulling it apart. And what I heard the speakers say, even though they did not use those two terms, is that the centripetal forces which would include the Soviet threat, which would include a certain degree of trust among the elites which would include a clear hierarchical relationship between the United States and Japan, that these centripetal forces keeping the relationship together are weakening. Whereas the centrifugal forces, such as concern about burden sharing, the particular irritation over the Gulf War, still problems over SII and so forth, that the centrifugal forces are strengthening. So if I had a meter here, my hunch is that the meter would show that still, as of this moment, the centripetal forces dominate the centrifugal forces and therefore the alliance remains together. But the centrifugal forces are gaining ground. And therefore, the relationship is at some risk. That's how I would summarize what I heard today.

Now, let me spend a couple of minutes, to consider how this fit into the broader prospective of the American debate at the moment, because I think you can't really look at the United States-Japan relationship in isolation. As important as it is, it's obviously going to be influenced by other and somewhat larger issues.

The way I hear the American debate at the moment, and its obviously very early since really we only have since late August a pretty clear cut confirmation of the collapse of the Soviet threat; before that we could still have a healthy argument about it. Now it's very hard to argue unless there is a major flip-flop very soon which is unlikely. But already I think, and this began before the August failed coup, you can discern four different schools, leading, I would submit, to four somewhat different paths for the future of America's global involvement.

Because I have limited time, I'm going to telescope it very quickly. The first I would call the incremental tactical approach which is what I would characterize the Bush Administration, which is basically no major surgery, no major changes anywhere, politically, militarily, or economically, but small, quiet, prudent steps that maybe over time will demonstrate some major change but in the short term you will not discern major differences. That's true whether you are looking at Japan or NATO or nuclear forces or so forth.

The second view, which is a bit bolder, I characterize as the selective engagement school which is now being espoused by such prominent individuals as Brzezinski, Huntington, Paul Nitze and others, which says that the main organizing concept of our foreign policy of containment is now antiquated; but we do need a new set of policies, and basically instead of having one over-arching policy, we're going to be very selective and just play in certain games and not play in a lot of others. But all of these gentlemen very much have Japan and East Asia in the political, military, and economic games that they wish to play. So I'm not sure ultimately that the

selective engagement is very meaningfully different from the first school in terms of United States-Japan relations.

The third school is what's been sometimes called the geoeconomic school or the economic primacy school that quite a number of commentators have espoused, including some refugees from the strategic studies community like Edward Luttwak. I think this school says we are now in a fundamentally new world; the world of military confrontation and the power, the political significance of military power is waning dramatically. The struggle for global power is a struggle for economic might, and it is absolutely essential now for the United States to jettison most of its ideas and most of the trappings of its military establishment and focus full time on bolstering its economic infrastructure and be much more aggressive in terms of its foreign economic policy. I think if that school were to become the hallmark of American policy, that would have profound effects on United States-Japan relations which I'll come back to in another minute or two.

The final school, for want of a better term what I call the "America come home" school. Notice that the third school made the promise of geoeconomics replace the value military power, but it's not in anyway a domestically oriented school. The fourth, the America come home school, largely is. That was the school of McGovern in the early 70s but its the school of Buchanan in the early 90s. It's the school of Doug Wilder and of Tom Harkin and of the CATO Institute, and of various individuals on the coast and the heartland of America. And they basically say there was only one fundamental reason to be as internationally involved as we needed to in the past and that was because of the Soviet Union, which we don't have to worry about any more. We have a rotting, decaying society at home; we're going to need several decades to repair it. And a lot of issues that any of us in this room care about really should be relegated to the scrap heap of policy and history. I don't personally believe that's likely to take hold in the short term, but one can never know.

Now I want to mention five American characteristics no matter what school we adopt, characteristics which we bring to the table, and finally come to some options. And I know I'm running a little late so I'll try and hurry. What are the five characteristics we bring to the table? I would say first we bring power projection to the table. We'll still have military power projection no matter how much we reduce our forces because we have the capabilities. We'll have a surface Navy, we have ballistic missiles, we have cruise missiles, we have long-range aircraft, in numbers and quality that no other nation possesses or will possess for some time. So in that sense, we have military power projection.

But we also have to pick up on some terms that Jeff Garten and others were talking about at one of the panels, we have values projection. People like to dance to our music and wear our jeans. And sometimes emulate our judiciary or our Congress. There are certain inherent characteristics of the American society which are appealing to a broad spectrum of people which are just not matched by the Japanese or the Germans or frankly the French or any other society. It's something we do bring to the table. We may not utilize it, we may not exploit it, but it's there.

Third, we remain and no matter how deeply troubled we are with our economic problems, we remain technology driven and to a substantial degree still technology dominant in some key areas. And reflecting on the Gulf War experience, I noticed and I was not alone in noticing this, the primacy of these technologies, the data processing capability that was needed to prosecute the war, the role of space as an emerging military platform, the role of directed energy, laser and particle beams for military purposes, the role of stealth technology and other methods of what is called signature control, and new manufacturing processes, the development of composite materials and other things which I won't get into now. One thing I notice about these technologies is that aside from the United States, the one other great nation that has the capacity to develop further these technologies for military purposes is Japan. In computer technology, in space and directed energy, and so forth, Japan has the fundamental basis, they've got the trained personnel; they've got the knowledge base, to apply this learning for military purposes if they choose to do so. And they could not choose to do so; they could choose to do so in service of the United States or others; they could choose to do so in service of themselves.

The United States will also bring to the table a certain moralistic tone in which we make value judgments about peoples and societies and stick to them based upon our own parochialisms, whether they are valid or not, and often embark on great adventures as a result of this. We're extremely unpredictable and I don't see that that will change. We'll say that Korea is outside our defense perimeter today and fight there for 3 years tomorrow. We'll say that we'll never fight another land war in Asia and the fight one for a dozen years; this is the heart and soul of American policy making, which is that it's hard for others to figure out what we're going to do because we ourselves don't know what we're going to from one moment to the next. Finally, and this is now a new development in what we're going to bring to the table, we're bringing to the table self-perceived economic weakness. We don't think we're very strong economically and in some ways it doesn't much matter whether we are or not. If we don't think we are, then we're not going to be. I think the Paul Kennedy notion of strategic overreach is taking hold in American elites; we're beginning to think we really overstepped our bounds.

Now given all of that, how is this bilateral relationship going to proceed. I think, I'm sorry again to have a magic number, four possible options, but they are interrelated options; they are not independent options. The first one I would characterize as a continuation of what Fred Bergsten calls competitive interdependence. I would modify that to say complex economic interdependence in which we continue to focus on the bilateral economic relationship on SII and other means of leveling the playing field. It is a basically not fully satisfactory set of policies and the continuation of the rise of Japanese economic power relative to American power continues. So option one is sort of more of the same.

Option two is that the continuing rise of Japanese economic power becomes for whatever set of reasons unacceptable to the United States. And policies, some of which perhaps you'll hear about in a few minutes from my colleague, are adopted, and the

net effect is a transformation of the relationship to one of economic rivalry, pure economic rivalry, and a collapse of economic cooperation in the bilateral relationship. I don't personally believe the United States and Japan can go on from day to day as economic rivals without it having subsequent effects.

I think this second option would lead to a third which is a political/military rivalry between the United States and Japan; in other words if both the United States and Japan adopt a set of economic policies, and because of the interest of time I won't spell them out now, it we become at each other's throats, to use Jeff Garten's term economically, I do not believe it will be possible to maintain a political and security relationship that's positive and on even keel.

A fourth option, of course, is that the management of the economic relationship as unsatisfactory to both sides as it is can still somehow be retained and it leads however to the growth of political and military power sharing. And I don't mean burden sharing. I mean power sharing between the United States and Japan where before the next bold adventure into the Gulf, there are quite clear cut bilateral agreements on the nature, the causes, the strategy, as well as the financing of these activities. I tend to be somewhat sympathetic to Garten's remarks that from an American perspective, Americans are most comfortable with the Japanese when the Americans dominate the Japanese. And when the Japanese are competitors or rivals and or doing better than we are, we become extremely uncomfortable. And I think the challenge ultimately before us is whether we can on the one hand, strengthen our own economic situation to become more competitive and at the same time allow ourselves to share in the power structure with Japan. If we fail at one or both of those, then I see ahead option two and then option three which will lead to a full scale rivalry in United States-Japan relations.

Mr. CRONIN. Thank you very much. And now our last speaker, Kevin Kearns.

REMARKS OF KEVIN KEARNS, FELLOW, ECONOMIC STRATEGY INSTITUTE

Mr. KEARNS. I think Michael Nacht has very nicely summed up a lot of the trends and the options and at the end of my remarks I guess you can put me in one of his categories. I think that when I wrote the original Team B article about 2 years ago, it was in the wake of the FSX process. I'd spent 2 years in Japan in Tokyo, and then gone to the Hill and wrote the article after that experience.

It seemed to me there was a growing resentment on both sides. And that the two nations were more or less on a collision course. And that if new methodologies, new options weren't put on the table for us to deal with one another and solve our problems, that eventually there would be some sort of clash, some sort of explosion. I didn't know when it would occur or exactly what shape it would take, but it was clear that hostility was growing. At the time I wrote the events in Eastern Europe had only started to unravel. Now of course we've been through a much more dramatic series of events.

I also wrote about the need for Japan at a minimum to maintain a strategic alliance with the United States because of its dependence on the oil in the Persian Gulf. Of course we had the Persian Gulf situation. The net result of having written this article was that I was a hardliner on Japan. I was a Japan basher.

I think maybe the first thing we need to do is to sort of demystify this whole debate and throw away the labels and really start again with some new categories. We have two very different economic systems. I think the remarks of all the panelists today and the questions brought that out. There is no question that the way Americans go about capitalism is not the way the Japanese do. And we don't have to assign blame for that. It's not good or bad, they are two different systems. Let's start with that as a fundamental point.

Let's throw away the notion that there is a conspiracy in Japan that Japan, Inc. exists and somehow it's out to get us. Let's throw away the notion of racism on both sides, that our problems are caused by racism. It seems to me, especially in light of the reaction to this University of Rochester—Japan 2000—report, Michael and I both testified before Representative Stephen Solarz when he was trying to get to the root of some of the controversy; and it seems to me the debate is often contained in rather sterile categories and we really have to break out from those categories. It's often very hard to discuss Japan or for someone like me to write another article or come up with what, at least what I think are new ideas, without being dismissed rather easily.

The Japanese press visit my office quite often and they are surprised I don't have fangs because of the stereotyping that's gone on. Policy makers are really way behind the power curve. I don't remember who said it this morning, but the business relationships really are moving ahead so rapidly that they are providing us with all kinds of new situations and new challenges. I think really that's where the essence of the clash and the tensions come.

There is certainly a lot to be discussed about how we allocate the military burdens on the security side in this world. But I think those are much more manageable than the economic tensions. The name of the game, ultimately, is cash. Wealth and economic power are I think what enabled the United States to be what it is.

We've done some polling recently at Economic Strategy Institute which we'll be writing up and releasing later in the fall, but the concerns of the American people at least if our polls are accurate, I would say center on about four economic issues. Foreign policy they really couldn't care less about, including the Persian Gulf. They are concerned about their standard of living overall; they are deeply afraid that in 5 years their standard of living is going to be a lot worse than it is today; they are deeply concerned about the number of jobs available in America and the kinds of jobs, especially available to young people graduating from high school and college, engineering schools for that matter, advanced degrees. They are concerned essentially about health care, social issues, but health care is the one that stands out the most, and they are vitally concerned about educating their kids. You can't do these things unless you're earning some money, unless you have a job and your businesses are earning money and they are paying taxes.

We talk a lot about education and improving education to make ourselves more competitive in this country. But which comes first. If you take a particular school district in Ohio and the auto parts plants have closed down, there are no taxes, and there is going to be no improvement in education unless there is revenue generated by industry and by individual taxpayers. So when I look at the situation, I'm really concerned about our industrial competitiveness, I'm concerned about jobs. This is really where the challenge, it seems to me, comes with Japan. Our two largest industries that are the easiest to pick since they are the largest employers and the largest percent of GNP of any industries are autos and electronics. We're facing incredible challenges from the Japanese in both those industries. The market share of our companies is dropping dramatically. As I mentioned this morning in the question period, our electronics industry has gone from about 56 percent world market share in the mid 80s to about 36 percent today. Most of the increase in market share, or our decrease has gone to Japanese competitors. We see the falling out of large segments of that electronics industry we see semiconductor manufacturing way down, semiconductor equipment makers reduced to a handful in the United States. We see companies like IBM, you think well how could Big Blue ever be in trouble. They are in very big trouble and they know it. That's why they are talking to some of their key rivals here; they can't produce a notebook computer. IBM Japan is making them, and Ricoh is making them for IBM Japan. Companies like Compaq are essentially assemblers of Japanese products with very, very little American value added in those products.

Take a look at the automobile industry, Japanese market share is now 31 percent; it's poised to climb. The name of the game in automobiles in this decade is differentiation. We will never again buy a million basic Chevys the way we did in 1957, the American family isn't the same, the tastes of our consumers aren't the same; no one wants to drive the same car as everybody else. So we have all these fancy MPVs and jeeps and real stratification in every segment. And the Japanese, they make great cars, there's no question about it. And a lot of our consumers, especially our younger consumers, have become enamored of those cars. But the question is what happens when you aggregate individual consumer choice. No one wants to say you can't buy Honda or whatever Japanese car it is, but in the aggregate, as our American auto industry declines, it is the largest consumer not only of glass, steel, rubber, plastics, it's the largest consumer of semiconductor chips. It's the largest consumer of software programs. It's the largest consumer of machine tools, largest consumer of robots. These are driver industries, electronics and automobiles. The upstream and downstream effects of their disappearing due to Japanese competition are really extreme. It's more than a ripple effect throughout the economy, it will be more of a tidal wave throughout the economy.

Now is the answer that the Japanese will save us? Mr. Okamoto said the Japanese now, I think you said, have 400,000 manufacturing jobs in the United States. Well, yes, they have created jobs, but the question is what is the net displacement of American jobs. In automobiles alone, we have probably lost 175,000 jobs. There are

different studies and they range from 11,000 to 400,000 jobs. I think about 175,000 in my research is a correct figure.

Congressman Oxley from Ohio asked me recently, I was testifying before his Committee, and he asked if I was upset that Honda created 2,000 jobs in his district. I said "no I'm not upset about that, but I'm upset about the 10,000 jobs that other districts lost as a result of that competition." So it seems to be that what we have to do with our economy is we have to decide that a whole number of strategic industries, and I don't mean that in the military sense, but there are strategic industries that the composition of our economy counts and we have to enable our firms in those industries to compete.

How do we do that? We have to really revamp the entire way that government does business and business does business. We're dealing with the Japanese economy, the Korean economy, other Asian economies, European economies, that are led by strong central states that have quite different government involvement. We seem to hate the word industrial policy in this country but for better or worse, we need some sort of national economic strategy. An economic strategy or industrial policy is not going to turn America into a centrally directed economy such as the Soviet Union. That seems to be the great fear, it's sort of like the Communist under the bed at night. It won't be European, it won't be Soviet, it won't be Japanese, it will be something that will evolve out of American traditions. But without additional government involvement, our companies cannot make it alone. I think that we have to revamp our tax system; we have to find a way to provide patient long-term capital, there are small steps you can take; you can do away with quarterly reporting requirements so our managers in business aren't looking over their shoulders at Wall Street every second. We have to create incentives to save and to invest, things like R&D tax credits, graduated capital gains taxes which favor long holding of shares or long-term investments as opposed to buying a house, renovating it, and flipping it, that type of thing.

Most of all, it seems to me, we need a national technology policy. Our wealth and increasingly wealth in the future is going to be based on technology. And this is the real strength in the United States. We talk a lot about dependence on Japanese technology, and the fact of the matter is it's really a two way street. The Japanese are forming joint ventures with many of our companies because obviously they have good technologies. And unfortunately there is not the venture capital around for these companies to turn to American sources of venture capital. But there is no question that the R&D establishment in the United States is the premier research and development establishment in the world. We cannot squander this resource as we have been doing in the past.

It seems to be that we need to go well beyond this support for basic research that is essentially is the administration's policy and has been the American policy for some time. And we have to base our wealth on a sort of advanced technology strategy for the rest of this decade and the next century.

I suppose to sum up then, I would say we need a national economic policy that no matter how well managed a particular company is, no matter how disciplined its labor force and educated it is,

no one can make it alone against large groups of foreign firms who are supported by strong central government intervention in their market places and central government policies. And we can do all these things without bashing anybody, without bashing the Japanese or the Europeans, etc. These are things we need to do here. We need to recognize the challenge for what it is, accept that challenge, and change our system to cope with it. Thank you.

Discussion

Mr. CRONIN. Thank you, Kevin. We are ready to take some questions now from the audience.

Question. Coming with few remarks from the globalist point of view, you talk about the revamping of those industries. Fine, but what time element? You have a time frame that has been eluding us, escaping us, year after year after year for the past years. You want to do anything here in terms of capital requirements, especially the domestic infrastructure, how can you do it with our insufficient saving rate? The savings rate has been traditionally low and very, very low the last half a decade. R&D you mentioned. R&D has only been going primarily for military purposes because of the Cold War. We are over that. Can we really end it? I have a question of time frame, and a question of basic policy which you all mentioned that must be talked about, looked at, decided and implemented.

Mr. KEARNS. I perfectly agree. It seems to me all these things hang together. That you can't sort of ignore education and eliminate a quarterly reporting requirement. That it's one seamless web. That either we put together a national policy and we implement it across the board or we fail. There is not much time left, I think. The patterns our trade negotiators and those in our foreign policy establishment are dealing with are changing so fast that the things they are negotiating about, they are negotiating about issues that really as far as I'm concerned, were over 10 years ago.

Not be too anecdotal, but the National Association of Manufacturers adopted the Team B idea and they made their own fixes based on their own needs. They wrote to the President in March and it took several months but Roger Porter, the President's chief domestic policy adviser wrote back and he said, "no we don't need a Team B on Japan or anywhere else. On Japan we're doing just fine; we had in essence a Team B at the start of the administration and SII grew out of that; and, by the way the bilateral trade deficit is way down, so things are fine." If you take a look at the trade deficit, the multinationalization of Japanese corporations, their movement into Southeast Asia, into Mexico and into Europe, it is skewing any sort of traditional notion of the bilateral trade deficit narrowly defined. These trade flows and their control by Japanese corporations are very significant and no one in the U.S. government is paying any attention to it.

Mr. NACHT. I just wanted to say that in some sense what a lot of the debate is about I think is if you accept the notion that in relative terms Japanese economic power is rising in comparison to American economic power, the question is to what extent does it have to do really with bilateral trade issues and matters than can be negotiated or not negotiated with Japan, and to what extent

does it have to do with the way we do business and basically American centric issues—structure, values, education and so forth. That's really where the debate is.

My own view is that the mix that explains the phenomenon that we observe is about 80 percent our problem or more. And Japan could vanish tomorrow, which I don't wish that it would do, and many of our problems would be right there. I'm in the education business, I could horrify you with stories about the poor preparedness of our college students and graduate students, and that was true when I was at the Kennedy School and it's true now that I'm at Maryland. And I see a lot of college campuses.

There are others who believe that a lot of the story is really in this bilateral relationship or particularly in Japanese strategies, and if we can fix those or adjust them or modify them, then a lot of these problems would disappear. And I think that's really where the debate is.

Mr. CRONIN. We'll have to try someone else.

Mr. ROBERT SUTTER, CRS. One of the most disturbing images I received from today's session was this image of Japan and Germany going back to their roots and that inexorably driving them away from us in a sense of values. I'm coming to Michael's talking about the forces that keep us together and the forces that drive us apart. With respect to the scenario that the economic forces will drive us apart, is there any sense that we have common political or cultural or other ties that would be important, or if these societies, particularly Japan, if they do indeed go back and do a self-examination and go back to their roots, is that going to be a force that drives them further apart from the United States in political/cultural realm?

Mr. NACHT. I tend to believe that it is a mixed picture but one in which there is a certain degree of homogeneity that is developing across societies because of modern life, because of communication and transportation. I remember having the discussion with Reischauer many years ago in which he said, "Michael, don't ever though confuse modernization with westernization. Japan may be as modern as any country in the world, but they are not western. And why should they be?" I don't know if it's appropriate to characterize what Garten said as alarmist, but I'm not as alarmed as he is about that. But I think in order to prevent these centrifugal forces from getting out of hand, you have to stay engaged and involved and slog on through SII and a thousand other issues all the time. If we develop a very adversarial posture, that I think will only promote the centrifugal forces, so it's not in our interests to do that. That's why I'm an advocate for staying deeply enmeshed, as painful and difficult and somewhat as unsatisfying as that is.

Mr. KEARNS. It seems to me too that if we take matters into our own hands, that is fix the things that we can fix, fix them here at home, not that it's easy to fix them and not that it wouldn't require several major reorientation of our political and economic system, that actually rather than having the Japanese see that as confrontational, they would understand it. They control foreign direct investment in their country very tightly. If we were more selective about the types of foreign direct investment we allowed, if we looked at what it means for technology transfer, whether there

is there a net gain or a net loss of jobs, things like that. This is part of their mindset. This is part of their frame of reference. So it seems to me that we can do a lot of the things that hardliners on the U.S. side are advocating without really causing conflict with Japan. Action doesn't necessarily have to be directed at Japan. It can be directed at world competition, all these economies that don't follow the same model as ours. And second, no one would understand it better than these people because they are practicing it themselves. I don't think it's necessary confrontational, I don't think it will destroy the bilateral relationship. So the point is I don't think we necessarily need to depend on just political stuff to keep us together.

Mr. GLENN McLoughlin, CRS. A quick comment and then I hope an even quicker question. I work on these issues of national technology policy, role of R&D consortia, funding for science and technology and its effectiveness; it appears that we really do have a national technology policy, it's just that it's not a unified one. We have a Stevenson Wydler National Cooperative Research Act of funding for technology transfer, it just hasn't been brought into the single umbrella which is a single set of goals or objectives that have been identified; we tend to identify sectors as they come up. My question that follows on and I'd like a couple of responses to and is the big issue for us at CRS in the last year has been this whole idea of critical technologies list. Anybody that has critical technologies list, they seem to be the same critical technologies, and here is an example of something that might be over-arching and comprehensive that doesn't necessarily mean a response United States vis-a-vis Japan. What do we do with something like critical technologies in light of some of the schools of thought that you identified and options and some of the things that you talked about.

Mr. CRONIN. Could I tag onto that same question and pose this one that if you look at the pattern of trade conflict or negotiations with Japan, and you've looked at all the things we've done, you can see that in fact there are very powerful American domestic interests which have had a large effect on policy and the things that have been done. The challenges that have been laid down, the issues that have been raised, have been raised by very powerful interest groups. And where issues have not been raised or where there is a feeling that the United States has not done very well in regard to Japan, particularly in the technology areas, sometimes it seems to arise because in fact the way the American system works certain interests are not as able to articulate their needs as others.

I agree with what Glenn is saying, that in a sense we have a de-facto industrial policy. We've got agricultural policies, we've got Buy American acts, we've got shipping policies, we've got all these things, but they don't appear to have much coherence and if you look at them from one perspective, it looks like we don't have a policy but once you analyze the things we do, you find it's very complex. Foreigners can tell us chapter and verse all the ways that we have some kind of equivalent of an industrial policy. I went to Canada one time on a United States-Canada North American defense market project and they had a laundry list of all the ways in which the United States didn't in fact follow through with what it

was supposed to be doing because of the minutia of policies that we had. Security information constraints, Buy American, etc. And what I'm getting around to is in our society, right now decisions are being made about our trade policies, about our investment policies, about our budget policies; they are being made by the play of interest groups. And that play of interest groups is producing one result. How do you get a different result? It's fine to say we don't like this one, but from a political point of view, how do you get a different one?

Mr. NACHT. Almost every one of Kevin's suggestions I would, in terms of how to fix the American system, I would support. But I think you just have to acknowledge the cultural constraints of our society, and I really think short of a national emergency which then does change things and galvanizes opinion in very special ways, short of that, you're just not going to be able to mobilize the kind of opinion and resources that you are talking about. When presidential candidates have spoken about industrial policy they have been slaughtered; corporations don't want to hear this even if it may be in their best interests. It just goes against the fundamental grain of the individual and the individual corporation and American life. I really think that that's why we're only sort of tinkering at the margins here with what we can do. It requires a Sputnik, literally a Sputnik, or something more dramatic, to change political opinion which is reflected on the Hill to pass legislation and create resources to do something radically different. Short of that, it's an incremental process that's just not going to get you where you want to go.

Mr. KEARNS. I would agree. It's, the question is how do we translate that political concern that I see and others see at the grass roots into a presidential candidate who will come in and really say what you need to do and legally seize control of the Executive Branch. Those of us who have worked on the Hill or who know the Hill know that you really can't do this in Congress alone. You can pass some good laws and you can steer things in the right direction, but without the power of the Executive Branch and people in departments and agencies carrying these policies out it won't work. Another problem is our Executive Branch really isn't set up to do this. And as a result we have 500 industrial policies and not one.

The flat panel displays which were mentioned this morning are a great example of that. These eight small U.S. companies, they are on the cutting edge of technology. They file a dumping suit; the large Japanese corporations, Hosiden, Toshiba, NEC, etc. are dumping these things in the United States, there's no question about that. But their main customers are IBM and Apple and Compaq and the large systems' integrators. And you have the large U.S. companies, because they think that U.S. policy is so feckless that it cannot guarantee the survival of these small startup technology companies, aligning themselves with in effect their rivals, these large Japanese companies. And then you have a situation where it's affected by this semiconductor agreement negotiations this summer. We removed, as part of a quick quid pro quo for that, duties on Japanese lap tops coming into the United States. And then in a separate action the ITC imposes duties on just the display screens themselves coming in. And what those two actions did was

they essentially make it economically unfeasible to import the screen itself. But it's okay to import the screen as part of a computer lap top or some other computer system. Now you have IBM saying we're going offshore to manufacture. And I don't know if you read David Sanger's piece in yesterday's New York Times but several Japanese companies said we've had it with this, we're not selling to our U.S. customers at all. If they want us to sell them in Singapore or whatever they want to manufacture, fine. And one sees the inconsistencies of our policy. If again to come back to a point I made during my remarks, it really has to be cohesive, it has to be across the board, and it has to be integrated or it's going to fail.

Mr. CRONIN. I'm going to take one more question, and then we're going to conclude.

Mr. JEFF YOUNG, CRS. I have a question for both of you and it's a followup to Bob Sutter's comment about Japan and Germany returning to their roots and then looking at what U.S. approaches under this situation might be. First I'd note that what have been implied here as the true "roots" of these countries happened under a very different and perhaps abnormal international context. Clearly the international context faced by Japan in the 1930s is not like the one faced by it in the 1990s. And one of the differences was that the U.S. really wasn't internationally involved to the extent that it is now. And noting that point and then looking at Mr. Nacht's discussion of four approaches the United States can take, I wondered if there was another one that you might have considered that would be a little bit more encompassing, some sort of U.S. strategy for the international system that would be able to restrain the centrifugal tendencies that, it would appear, the different national economic systems are engendering. What I have in mind is something like another Breton Woods, like another GATT, like another post-World War II liberal international economic order if the collapse of the Soviet Union allows that. Looking at the four approaches, they all seem to be quite similar to each other and they are all very modest. I wondered if either of you have any ideas for a U.S. international strategy, let alone just a domestic one.

Mr. NACHT. I think that Fred Bergsten and Bob Lawrence both basically alluded to that, and I think it would take the investment of some energy and attention and political capital on the part of the administration to do that. I'm not sure frankly that, well I think it's quite unlikely they would do that before the election of '92. But perhaps, if Bush is reelected, then in his second term, this would be on the agenda, especially for someone like Baker who would of course himself be looking for other mountains to climb.

Mr. CRONIN. Kevin, do you have a response?

Mr. KEARNS. No, that's fine.

Mr. CRONIN. Well, we've had a very long and intense day, but I think one extremely rich in ideas. And it's going to take a long time to sift through all these ideas and digest them. I would like to thank in particular Michael Nacht and Kevin Kearns, our last panelists, for coming to grips with some of these big questions and giving us some policy options to think about as we go away from here. Thank you all very much.

I would remind you that we are going to do a committee print from this. It will be published by the House Ways and Means Committee and the basic idea will be first to write a kind of overview which will try to synthesize and make some sense of the discussion. Michael has been very helpful in that regard with his comments this afternoon. And that may be published as a CRS report first, but then we will package together the transcript of the proceedings plus this overview.

In addition, there is going to be another seminar in Japan, in Tokyo, on November 25, which is going to address a similar theme, and Bob Sutter and I are going there thanks to the support of the Asia Foundation. We will be trying to present at that session again the gist of some of the things that came up here and the Japanese will be looking at essentially the same kinds of questions from a Japanese perspective. And when we come back, we will try somehow to put all that together and see if we can come up with some kind of product which will distill the differences, the comparisons and contrasts between how the Americans and the Japanese have looked at essentially the same kinds of problems.

Thank you again, all of you, for your interest, and for coming here. I want to thank our last two panelists and all the other panelists for an outstanding job. Thank you very much.



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